

FINANCIAL RESTRUCTURING PROPOSALS

HEARING
BEFORE THE
COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE
ONE HUNDREDTH CONGRESS
FIRST SESSION
ON
EXPANDING THE POWERS OF BANKS AT THE STATE LEVEL AND THE
FINANCIAL SERVICES HOLDING COMPANY ACT

AUGUST 5, 1987

Printed for the use of the Committee on Banking, Housing, and Urban Affairs



U.S. GOVERNMENT PRINTING OFFICE

WASHINGTON : 1987

76-725

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

5241-26

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FINANCIAL RESTRUCTURING PROPOSALS

WEDNESDAY, AUGUST 5, 1987

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The committee met at 10 a.m., in room SD-538, Dirksen Senate Office Building, Senator William Proxmire (chairman of the committee) presiding.

Present: Senators Proxmire, Dixon, Shelby, Garn, D'Amato, Hecht, and Bond.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

The CHAIRMAN. The committee will come to order.

I have a very serious announcement to make before I get into the statement by the two witnesses this morning.

The Senate Banking Committee baseball team, known as the Senate Bank Robbers, last night won their last regular game 8 to 5 and I'm proud and happy to say that the season record for them is 8 and 1, which is fantastic.

They now go to the Super Bowl. The division playoffs are next Wednesday. Lory Breneman is the manager-owner, equivalent to George Steinbrenner. So we are all set for the New York Mets or the Milwaukee Brewers or that great team out in Utah that won 27 straight.

At any rate, we are very proud of the fact that they are so good and they are good only because no members play on the team. [Laughter.]

Yesterday, Congress completed work on our first major banking bill in 5 years. The vote was 96 to 2. Today, we address specific legislative proposals for the second major banking bill. I hope we can finish it in 5 months instead of 5 years and with a better than 96 to 2 majority.

We are privileged to hear expert testimony on two proposals today. One is aimed at expanding the powers of banks at the State level. Ours, as we know, is a dual banking system, meaning that we have both Federal and State regulation of banking. States have long been laboratories for experiment. Perhaps States are the ideal method for laying the groundwork for more sweeping Federal financial law.

We will also hear about the Financial Services Holding Company Act, which actually has been introduced in the House and Senate, enjoying the sponsorship of my worthy colleague, Senator Jake Garn, who honors us with his presence here and, of course, was chairman of the committee for many years.

Among the attractions of this idea is that it builds on a proven foundation, namely the bank holding company. Our Federal Reserve has performed laudibly in bolstering the safety and soundness of the banking system through the regulation of holding companies. Despite scandals and the recent bad time in the farm and oil States, our banking system is relatively healthy. The Federal Deposit Insurance Corporation is strong.

With these and other proposals, however, we are treading on delicate ground. Should commerce and banking be mixed? Should investment and commercial banking be joined? We must know how to preserve safety and soundness and insulate against conflicts of interest.

I look forward to hearing from our distinguished witnesses on how these problems can be overcome.

Senator GARN.

OPENING STATEMENT OF SENATOR GARN

Senator GARN. Thank you, Mr. Chairman.

Yesterday we did pass the banking bill by an over-whelming margin and with my support. I am pleased that it passed. The fact that it had been 16 months since the administration asked us to do something about the problems of FSLIC. So that was the engine that drove that bill and I'm pleased we were able to get more out of the House conference committee than either the Senate or the House had in their original versions—\$10.825 billion.

I still would have preferred that we have a clean FSLIC, but recognizing the realities of the Congress, we did the very best we could with that bill.

But it is a stop-gap measure of moratoria that expire next March, so I am pleased that we are proceeding with hearings the very next day. I make the pledge to the chairman that I did yesterday on the floor that I will do everything I can to help him produce comprehensive legislation because the fact still remains that the fundamental structure of our financial system is outmoded.

It's a shame that we have not been able to move sooner. It's now been 3 years since a comprehensive bill passed the Senate on a 89 to 5 vote. So we seem to be able to get rather large margins in the Senate to do something about the outmoded structure and the House of Representatives continues to be the stumbling block.

So I hope, Mr. Chairman, that we are not in the same position that by next March we're able to produce another bill in the Senate and the House sits on their hands and does nothing. I think it's important that we proceed as rapidly as possible and when those moratoria expire we are ready to proceed, if not by then, hopefully before then, with some comprehensive legislation. Thank you.

The CHAIRMAN. Thank you, Senator Garn.

Senator D'AMATO. Mr. Chairman, I would like to submit a statement as if read in its entirety.

The CHAIRMAN. Or course. It will be printed in full in the record. Are there any other Senators that want to submit a statement at this point?

Senator DIXON. I have a statement.

The CHAIRMAN. We also have statements for the record from Senators Sasser and Heinz.

STATEMENT OF SENATOR ALAN DIXON

Senator DIXON. Mr. Chairman, I am pleased to be here this morning as the Banking Committee continues its hearings on financial services industry reform issues. We have a distinguished group of witnesses before the committee today, and I look forward to their testimony.

We have already heard a number of suggestions as to how best to overhaul our outdated banking laws. Gerald Corrigan, president of the New York Federal Reserve Bank, former Citicorp chairman Walter Wriston, and managing director of Salomon brothers Henry Kaufman have all made proposals in testimony before this committee.

Congressman Thomas Carper has also made a very creative suggestion for reform legislation which is based on utilizing the States as the mechanism for expanding bank asset powers outside the securities area. I am very interested in hearing the details of his proposal.

There are a number of other legislative proposals which either are already in circulation or currently being drafted. All of them are important to this committee. Having a good range of options will help the committee craft good legislation.

Having said that, however, I also want to say that it is important that we not get ahead of ourselves. We need to have a good understanding of the major changes affecting our financial services industry, such as securitization and internationalization of financial markets, before we act. We need to understand how our law relates to banking law in other major banking countries.

This series of hearings provides a good base for beginning our efforts to achieve long overdue structural reform. While I do not underestimate the difficulties involved in developing a bill that can be enacted this year, I think it is possible for this committee to report a bill that addresses the rapidly changing situation facing our financial services industry today. The proposals we have already received, and those that will be discussed this morning, are important contributions to the committee's effort to craft the kind of forward-looking solution that is needed.

STATEMENT OF SENATOR JIM SASSER

Senator SASSER. Mr. Chairman, I look on the subject of today's hearing with great interest. The Financial Services Holding Company proposals offer great promise to better serve consumers, to provide for more efficient capital flows and to better enable us to compete in the world economy.

Yet, at the same time, the combination of the industries which are contemplated in these proposals, namely banking, securities, insurance and real estate, offers an enormous potential for risk to the deposit insurance and payments system, conflicts of interest and increased economic concentration. One of the basic tenets of banking law is at stake: The separation of banking and commerce.

In particular, we are considering doing away with a law that has served this country well for over 50 years: The Glass-Steagall Act. Admittedly, times have changed. I am the first to admit that. Some expansion of bank products and services may be advisable. However, I can not emphasize enough that the benefits of such drastic deregulation must be carefully weighed against the risks. I am looking forward to today's testimony.

STATEMENT OF SENATOR JOHN HEINZ

Senator HEINZ. Mr. Chairman, I join you in welcoming our distinguished witnesses today, Congressman Tom Carper and John LaWare, Chairman of Shawmut Corporation, who will testify on two proposals to restructure the financial services industry.

Mr. Chairman, this week is a significant week for the financial services industry. The House, on Monday, and the Senate, yesterday, approved by an overwhelming bipartisan margin a major banking bill that will recapitalize the Federal Savings and Loan Insurance Corporation, ban the creation of nonbank banks, prohibit lengthy holds on depositors' checks, provide relief to farm banks hit by adverse economic conditions, and put a moratorium on new bank powers until next March.

The legislation is significant for two reasons. It is the first major banking legislation in 5 years. It clears the agenda of the immediate problems. More importantly, through the moratorium, it creates the proper environment for this committee and Congress to review and consider major reform for the financial services industry.

Mr. Chairman, you and the ranking member of the committee, Senator Garn, are to be congratulated for your efforts in moving the legislation and setting the proper scene within which this committee can conduct a comprehensive review of the financial services industry.

The comprehensive review is already underway. Today, the committee will examine various legislative proposals which have been advanced to restructure the industry.

While these proposals differ as to the specifics, all contain a common theme: That banking and commerce can be successfully integrated without threatening the safety and soundness of the system. Most advocates have proposed a holding company structure to ensure corporate separateness—putting all nontraditional financial functions in subsidiaries and then trying to insulate the bank from the risks of the nonbank subsidiaries.

The diagram sounds fine on paper, Mr. Chairman; however, will that work in the real world? In the real world, we have to concern ourselves with the issue of whether such integration—albeit through separate subsidiaries—will lead to the undesirable propagation of the deposit insurance guarantee and its corresponding hazards. Deposit insurance is a central, if not the essential feature of our present banking system. However, it can create an undesirable side effect—an incentive for excessive risk taking because an insured bank can attract funds at a risk-free rate. Even if we insulate the bank from the nonbank subsidiaries, can we remove the "subsidy" provided by deposit insurance that would propagate to

the nonbanking activities of the organization, should problems develop?

There are several other reasons why the corporate separateness theory is unlikely to succeed. Most important is the very strong profit incentive for a corporation—whether a financial services or bank holding company—to manage its various subsidiaries as a single entity. While it might be possible to enforce corporate separateness strictly, and truly insulate the bank, would doing so severely restrict or even eliminate the synergies the consolidated organization might otherwise enjoy? From a purely organizational viewpoint, I have reservations as to whether the erection of legal barriers between banks and their nonbank subsidiaries would be enough to remove the incentives for the propagation of deposit insurance guarantees.

Other factors may tend to diminish the potential for corporate separateness: Right now bank holding companies tend to use affiliate relationships to avoid capital and other regulatory constraints imposed on banking activities, and, in fact, are reluctant to let their nonbank affiliates fail. From a legal standpoint, it is unclear whether the liability of a subsidiary can be effectively separated from that of its parent.

These are issues that need to be addressed in detail, Mr. Chairman. We have just bailed out one insurance fund, at considerable cost to the industry and depositor confidence. Another bailout—of either insurance fund—could be devastating, if not the death knell, to our Nation's banking system. I would hope that the witnesses and the committee examine this issue closely.

STATEMENT OF SENATOR ALFONSE M. D'AMATO

Senator D'AMATO. This morning's hearings and those that will certainly follow are important if we are to satisfy one of the provisions of the Competitive Equality Banking Act which we passed yesterday. Specifically, I am referring to section 203. That section declares that it is the intent of the Senate, through its Committee on Banking, Housing, and Urban Affairs, to conduct a comprehensive review of banking and financial laws, and to make decisions on the need for financial restructuring legislation before the expiration of the moratorium contained in title II.

The testimony of this morning's witnesses, especially the statements from our colleagues in the House, should greatly facilitate our efforts. If we are ever to enact comprehensive legislative reform designed to ensure the safety and soundness of our financial markets, our colleagues in the House must engage in a parallel effort. I look forward to their thoughtful testimony this morning and the testimony of our other witnesses.

The CHAIRMAN. I think our first witness, Congressman Carper, is one who has not been sitting on his hands. He is a very innovative congressman. He has an excellent proposal this morning and we are delighted to hear from him.

Mr. Carper, we are going to see if we can limit the testimony of each witness to 10 minutes to begin with and then we will limit the questioning so that we can get through as much as possible. Go right ahead.

STATEMENT OF THOMAS R. CARPER, U.S. HOUSE OF
REPRESENTATIVES FROM THE STATE OF DELAWARE

Representative CARPER. Thank you very much, Mr. Chairman and Senator Garn and Members of the Committee.

I appreciate very much the invitation to appear before you today as a witness in your ongoing hearings on restructuring the delivery of financial services in our country. I commend you and your committee for your commitment to thoroughly examining the issues and marking up a subsequent bill in short order, and I look forward to a similar opportunity in the House Banking Committee and, indeed, will be a catalyst for action in that body.

The conference report on H.R. 27, which, as you said in your opening statement, has been enacted in both the House and the Senate, sets the stage for Congress to seize the initiative from the regulators and from the courts and to expand, where that's appropriate, the products and services delivered by commercial banks. I believe this issue is a critical one. Banks have seen an erosion of their traditional business as credit has become increasingly securitized. This development has diminished their ability to compete both at home and abroad. It's led to a decreased profitability. The ability of the U.S. banks to conduct securities activities abroad which are prohibited at home has led to the exportation of jobs and it's led to the exportation of business to foreign capital markets. In order to ensure bank safety and soundness, I think we need to prevent excessive risk-taking, but we must also allow them to deliver products and services that are a reasonable evolution of their traditional role.

H.R. 3063

To this end, last week I introduced H.R. 3063, the Dual Bankings System Enhancement and Financial Services Competitiveness Act. I introduced it with Congressman George Wortley as the principal Republican sponsor. This legislation contains really two major initiatives. Under this bill, bank holding companies would be permitted to own registered broker-dealers that conduct full securities activities with two notable exceptions—with the exception of underwriting corporate equities and with the exception of underwriting corporate debt with maturities over 270 days. In addition, the bill would allow national banks to engage in the same activities authorized for State chartered banks, but only in the State in which they are located. These activities would only be conducted within that State, so that we would not end up with another South Dakota loophole.

The approach embodied in this bill does not preclude a more fundamental restructuring reform at the Federal level. Enactment of these provisions could be an interim step in our progress towards one of the financial service holding company structures advocated by many within the Congress and also in the private sector. I think it is important that we refocus the debate and that we move forward.

I have advocated expanded securities powers for banks for several years. When I was Treasurer of the State of Delaware, one of my responsibilities was to serve as bond issuing officer. The State's

general obligation bonds, which were backed by the full faith and credit of our State, sold to raise money for capital improvements, such as schools, prisons and roads—those bonds could be underwritten by both commercial and investment banks. On the other hand, when we were about to issue tax exempt revenue bonds issued by the Delaware Solid Waste Authority, by the Delaware Health Facilities Authority, or by the Delaware Transportation Authority, those tax exempt revenue bonds could only be underwritten by investment banks. Commercial banks could not compete. As a result of that diminished competition, we paid a higher interest rate on the revenue bonds than we probably needed to pay in order to sell them.

Similarly, I consider mortgage-backed securities, along with commercial paper and securities backed by consumer credit, to be a natural evolution of traditional banking products and services and, therefore, an appropriate activity for banks.

After considerable thought, I decided not to propose a laundry list of new, authorized securities activities. Rather, it seemed reasonable to me, in a world of rapidly developing securities instruments, to allow for the inevitable change in instruments that will continue to take place, and to specify what is prohibited instead of what is allowed. This would eliminate continued litigation to determine whether each new derivative of current instruments is indeed a permissible activity. Banks would have much of the flexibility they now successfully enjoy everywhere in the world except in the United States.

EXPANDED BANK POWERS

The rest of the bill allows national banks to benefit from the initiatives States have taken in the areas of financial services delivery. It is in the tradition of the dual banking system and self-determination of States to permit the States to determine the system of distribution of financial services that best meets the needs of their citizens. Many States have already acted to expand the role their banks can play in the State and local economy. Importantly, this bill does not require any State to make any changes, nor does it mandate a direction. It does preserve the right of each State and its citizens to decide what makes the most sense for them.

My bill places State initiatives in a Federal construct by requiring notice and approval for activities which are now allowed under Federal law. This means that the Comptroller of the Currency and the Board of Governors will continue to safeguard the safety and soundness of our commercial banks and to protect the payment system at the same time that the banks diversify their products and services. Clearly, Federal standards have to be met, as Federal deposit insurance stands behind these institutions. It is possible to encourage competition and innovation and prevent excessive risk at the same time. Thus, the bill does not advocate allowing banks to enter any business they choose. But sensible activities with reasonable safeguards should be encouraged.

Should expanded bank powers mean less examination and supervision? No, they shouldn't. New activities require greater vigilance on the part of regulators. I believe we need more and better

trained examiners to do the job. To this end, I introduced a bill in the 99th Congress which was passed by the House. That bill would have led to an enhanced system of examination and supervision for Federal and State regulators. At the beginning of the 100th Congress I reintroduced this bill in the House. I am pleased that Senator Riegle shared my concern and introduced a similar bill in the Senate. I urge you to give this issue serious consideration as you examine the structure of our financial services industry.

And I might just add, as an aside, that H.R. 27 which has been enacted includes a provision of the bill that I've introduced and a provision of the bill that Senator Garn introduced with regards to exemption from Gramm-Rudman requirements and changes in the apportionment and exclusion of the anti-deficiency provisions of the law, and I commend you for your work and that effort.

In conclusion, who benefits from this bill? For the most part, we all do. Consumers benefit from increased competition and therefore lower prices. Their interests should be a top priority. Commercial banks benefit by being able to recapture some of their best customers who have moved to other markets. And this is not just a bill for big banks. The diversity and flexibility that would arise from this approach would offer a myriad of choices for small banks as well. Better profits for banks mean stronger institutions and a more sound system. I am not advocating excessive risk. I am advocating reasonable activities coordinated with meaningful examination, supervision and regulation. And I thank you for the opportunity to testify this morning.

CROSSROADS OF OPPORTUNITY

In conclusion, Mr. Chairman, I think we are at the crossroads of opportunity. The time has come for us to take control of the destiny of our financial institutions and to develop public policy that makes sense in the light of the expanding global financial system around us.

We can continue to sit back and watch while the world changes without our input, or we can take control and be sure that change takes place in a rational, legal structure, meeting the policy goals that we have established.

At the appropriate time, Mr. Chairman, I will be happy to attempt to answer any questions that you may have.

[The complete prepared statement of Thomas R. Carper follows:]

The CHAIRMAN. Thank you, Congressman Carper, for a fine statement.

Our next witness is John LaWare, Chairman and Chief Executive Officer of the Shawmut Corporation of Boston.

The CHAIRMAN. Mr. LaWare, go ahead, sir.

**STATEMENT OF JOHN P. LAWARE, CHAIRMAN, SHAWMUT CORP.,
BOSTON, MA**

Mr. LAWARE. Thank you. Mr. Chairman and Members of the Committee, I certainly appreciate the opportunity to appear here this morning.

I have three documents with me that I request be made a part of the record of these hearings. First is the text of the bill, the Financial Services Holding Company Act, which we intend to cause to be introduced in the Congress. The second is a section-by-section analysis of the bill. And the third is a series of questions and answers about the bill which I would hope would be part of the record of these hearings.

The CHAIRMAN. They certainly will be incorporated in the record.

Mr. LAWARE. Thank you.

We call our bill The Financial Services Holding Company Act and the basic details are complete and in place and are incorporated in the draft which we have submitted.

I am not going to bore you all by reading the statement which has formally been submitted, but rather I would like to cite some of the high points in the proposal that we have made and go forward in that less formal fashion.

ENDORSEMENTS OF LEGISLATION

I would point out that the concept that we are talking about here is one which has been discussed in the banking industry for the past year and a half and it has now been endorsed by, in addition to the Association of Bank Holding Companies which essentially drafted this legislation—it has subsequently been endorsed by the Bank Capital Markets Association, the Consumer Bankers Association, and the Board of Directors of the American Bankers Association, and will be the subject of their leadership conference deliberations in September for general endorsement by the entire association.

I am here not representing any association, but rather representing the Shawmut Corporation, which is a bank holding company. I have been closely associated with the development of this concept, but the views I am expressing here today are those of the Shawmut Corporation.

Just to put this in perspective, I don't think anything quite like this has ever been proposed in the Congress and we recognize that it is such a new concept that it will take a great deal of study and debate. We do not expect immediate enactment and I would be very surprised if the final version of this legislation didn't differ substantially from what is incorporated in the present draft. But we believe that it is an excellent beginning and one that focuses attention on a new approach.

I might add parenthetically that this is not just a commercial bank proposition at this point. We are getting increasing interest in this concept from insurance companies and even from securities firms who recognize it as an opportunity to horizontally integrate the financial services industry without anyone giving up something that they currently enjoy in terms of a market.

Let me talk just briefly about the basic concept. We came to this concept because we have for many years been frustrated that we could not obtain congressional support for a fundamental reorganization of the structure of the financial services industry, and the light dawned on us commercial bankers when we realized that the reason we weren't getting anywhere was that we wanted something from somebody else and we weren't giving anything in return. It was not a two-way street. It was a wish list of additional powers for commercial banks at the expense of some of our colleagues in the financial services industry.

So this approach essentially is a balanced one which gives something to securities firms, insurance firms and so forth in the way of being able to get into full service banking, and it gives banks an opportunity to participate in those other segments of the financial services industry.

We propose that any company financial in nature can affiliate with a bank through this new financial services holding company. Institutions that are not banks would be permitted to form such holding companies as well, and own banking institutions as long as they were financial in nature.

It would be a corporation chartered under State law, owning a bank holding company, and one or more other companies that are financial in nature. That is, insurance, securities, real estate agency and development—not ownership and management of properties, but rather the agency or brokerage and development portion of the real estate industry.

But not commerce. We believe that the barrier between banking and commerce is a valid one and our proposal is designed to keep that in place. We think that it is up to Congress to deal with the commerce and banking issue, but our viewpoint is that the present distinction is a sound one.

Now the cornerstone of The Financial Services Holding Company is a bank holding company. And the reason that we have decided to do that is that the holding company is the dominant form in the banking industry today. Almost 10,000 of the 14,000 banks in the country are affiliated in one way or another with a bank holding company.

BANK HOLDING COMPANY STRUCTURE

The second reason is that the bank holding company structure is presently regulated by the Federal Reserve System and that is a very sophisticated method of controlling the interrelationship between a bank and nonbank affiliates, those that are presently allowed under Section 4(c)(8) of the Bank Holding Company Act. We have also added to this legislation a section 23(b) to the Federal Reserve Act similar to the one contained in the recently passed legislation which provides further arm's length restraints on the rela-

tionship between a bank and its nonbanking affiliates. And we believe that that strengthens safety and soundness.

So as we get right down to it, our fundamental belief is that in order for this legislation to succeed, the two issues that must be addressed are safety and soundness and consumer benefits. We believe that safety and soundness is provided for because the banking pod or section of this holding company is insulated from the other parts—the securities firm or the real estate firm or the insurance firm—in the sense that the bank cannot finance the operations of those affiliates nor can it transfer capital to those affiliates. These are similar to the kinds of constraints that are built into the Bank Holding Company Act for banks dealing with nonbanking affiliates.

The second issue is that the Federal or State regulators now responsible for the regulation of these various segments of the financial services industry would continue as is. The insurance companies would continue to be regulated by the State insurance authorities; the securities affiliates would be regulated by the SEC. So there is no necessity to impose a new vehicle for regulation.

Finally, as to the consumers, we believe that this integration which in a way is similar to the development of supermarkets in retailing will benefit consumers by providing greater convenience, more competition, and if it follows the supermarket example, eventually lower prices.

Mr. Chairman, when you and I were a lot younger than we are now back in Wisconsin, if you remember, in food retailing, you had a butcher in town, a baker, you might have a fish market in town, you had a grocery and you had a drugstore and a hardware store. Most of the things that you used to have to go to five different locations for are now available in the typical supermarket, in addition to the latest edition of the National Enquirer and books and razor blades and a few other things. That has resulted in a much more efficient distribution system and in lower prices to consumers, and I submit that the comparison here with the financial services holding company is a valid one.

Finally, we believe that H.R. 27 which has just been passed by both houses is an important move, and we believe that the recapitalization of the Federal Savings and Loan Insurance Corporation, although inadequate in our opinion in terms of a long-run solution to that problem, is a much needed event. And while we are still searching for a long-range solution to banking and we compliment you, sir, on these hearings in an attempt to get some ideas out on the table, we think that the financial services holding company addresses itself to all of these issues without interfering with the safety and soundness of the banking system.

Thank you.

[The complete prepared statement of John P. LaWare follows:]

TESTIMONY BEFORE THE SENATE BANKING COMMITTEE

THE HONORABLE THOMAS R. CARTER

AUGUST 5, 1987

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MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE. I APPRECIATE THE INVITATION TO APPEAR BEFORE YOU TODAY AS A WITNESS IN YOUR ONGOING HEARINGS ON RESTRUCTURING THE DELIVERY OF FINANCIAL SERVICE IN THE UNITED STATES. I COMMEND YOU FOR YOUR COMMITMENT TO THOROUGHLY EXAMINING THE ISSUES AND MARKING UP A SUBSEQUENT BILL. I LOOK FORWARD TO A SIMILAR OPPORTUNITY IN THE HOUSE BANKING COMMITTEE.

THE CONFERENCE REPORT ON H.R. 27, WHICH SHOULD SOON BE ENACTED, SETS THE STAGE FOR THE CONGRESS TO SEIZE THE INITIATIVE FROM THE REGULATORS AND THE COURTS AND EXPAND, WHERE APPROPRIATE, THE PRODUCTS AND SERVICES DELIVERED BY COMMERCIAL BANKS. THIS ISSUE IS A CRITICAL ONE -- BANKS HAVE SEEN AN EROSION OF THEIR TRADITIONAL BUSINESS AS CREDIT HAS BECOME INCREASINGLY SECURITIZED. THIS HAS DIMINISHED THEIR ABILITY TO COMPETE AT HOME AND ABROAD, LEADING TO DECREASED PROFITABILITY. THE ABILITY OF U.S. BANKS TO CONDUCT SECURITIES ACTIVITIES ABROAD WHICH ARE PROHIBITED AT HOME HAS LED TO THE EXPORTATION OF JOBS AND BUSINESS TO FOREIGN CAPITAL MARKETS. IN ORDER TO ENSURE BANK SAFETY AND SOUNDNESS, WE NEED TO PREVENT EXCESSIVE RISK-TAKING, BUT WE MUST ALSO ALLOW THEM TO DELIVER PRODUCTS AND SERVICES THAT ARE A REASONABLE EVOLUTION OF THEIR TRADITIONAL ROLE.

TO THIS END, LAST WEEK I INTRODUCED H.R.3063, THE DUAL BANKING SYSTEM ENHANCEMENT AND FINANCIAL SERVICES COMPETITIVENESS ACT, WITH CONGRESSMAN GEORGE WORTLEY AS THE PRINCIPAL REPUBLICAN SPONSOR. THIS LEGISLATION CONTAINS TWO MAJOR INITIATIVES. UNDER THIS BILL, BANK HOLDING COMPANIES WOULD BE PERMITTED TO OWN REGISTERED BROKER-DEALERS THAT CONDUCT FULL SECURITIES ACTIVITIES WITH THE EXCEPTION OF UNDERWRITING CORPORATE EQUITIES

AND CORPORATE DEBT WITH MATURITIES OVER 270 DAYS. IN ADDITION, THE BILL WOULD ALLOW NATIONAL BANKS TO ENGAGE IN THE SAME ACTIVITIES AUTHORIZED FOR STATE-CHARTERED BANKS IN THE STATE IN WHICH THEY ARE LOCATED. THESE ACTIVITIES WOULD ONLY BE CONDUCTED WITHIN THAT STATE, SO THAT WE WOULD NOT CREATE ANOTHER SOUTH DAKOTA LOOPHOLE.

THE APPROACH EMBODIED IN THIS BILL DOES NOT PRECLUDE A MORE FUNDAMENTAL RESTRUCTURING REFORM AT THE FEDERAL LEVEL. ENACTMENT OF THESE PROVISIONS COULD BE AN INTERIM STEP IN OUR PROGRESS TOWARDS ONE OF THE FINANCIAL SERVICE HOLDING COMPANY STRUCTURES ADVOCATED BY MANY WITHIN CONGRESS AND IN THE PRIVATE SECTOR. IT IS IMPORTANT THAT WE REFOCUS THE DEBATE AND MOVE FORWARD.

I HAVE ADVOCATED EXPANDED SECURITIES POWERS FOR BANKS FOR SEVERAL YEARS. WHEN I WAS TREASURER OF THE STATE OF DELAWARE, ONE OF MY RESPONSIBILITIES WAS TO SERVE AS A BOND ISSUING OFFICER. THE STATE'S GENERAL OBLIGATION BONDS, BACKED BY THE FULL FAITH AND CREDIT OF THE STATE AND SOLD TO RAISE MONEY FOR CAPITAL IMPROVEMENTS, COULD BE UNDERWRITTEN BY BOTH COMMERCIAL AND INVESTMENT BANKS. ON THE OTHER HAND, THE TAX-EXEMPT REVENUE BONDS ISSUED BY THE DELAWARE SOLID WASTE AUTHORITY, THE HEALTH FACILITIES AUTHORITY, OR THE TRANSPORTATION AUTHORITY, COULD ONLY BE UNDERWRITTEN BY INVESTMENT BANKS. COMMERCIAL BANKS COULD NOT COMPETE. AS A RESULT OF THAT DIMINISHED COMPETITION, WE PAID A HIGHER INTEREST RATE ON THE REVENUE BONDS THAT WE PROBABLY NEEDED TO PAY TO SELL THEM.

SIMILARLY, I CONSIDER MORTGAGE-BACKED SECURITIES, COMMERCIAL PAPER, AND SECURITIES BACKED BY CONSUMER CREDIT TO BE A NATURAL EVOLUTION OF TRADITIONAL BANKING PRODUCTS AND SERVICES AND, THEREFORE, APPROPRIATE ACTIVITIES FOR BANKS.

AFTER CONSIDERABLE THOUGHT, I DECIDED NOT TO PROPOSE A LAUNDRY LIST OF NEW, AUTHORIZED SECURITIES ACTIVITIES. RATHER, IT SEEMED REASONABLE, IN A WORLD OF RAPIDLY-DEVELOPING SECURITIES INSTRUMENTS, TO ALLOW FOR THE INEVITABLE CHANGE IN INSTRUMENTS THAT WILL CONTINUE TO TAKE PLACE, AND SPECIFY WHAT IS PROHIBITED, INSTEAD OF WHAT IS ALLOWED. THIS WOULD ELIMINATE CONTINUED LITIGATION TO DETERMINE WHETHER EACH NEW DERIVATIVE OF CURRENT INSTRUMENTS IS A PERMISSIBLE ACTIVITY. BANKS WOULD HAVE MUCH OF THE FLEXIBILITY THEY NOW SUCCESSFULLY ENJOY EVERYWHERE IN THE WORLD EXCEPT IN THE UNITED STATES.

THE REST OF THE BILL ALLOWS NATIONAL BANKS TO BENEFIT FROM THE INITIATIVES STATES HAVE TAKEN IN THE AREAS OF FINANCIAL SERVICES DELIVERY. IT IS IN THE TRADITION OF THE DUAL BANKING SYSTEM AND SELF-DETERMINATION OF STATES TO PERMIT THE STATES TO DETERMINE THE SYSTEM OF DISTRIBUTION OF FINANCIAL SERVICES THAT BEST MEETS THE NEEDS OF THEIR CITIZENS. MANY STATES HAVE ALREADY ACTED TO EXPAND THE ROLE THEIR BANKS CAN PLAY IN THE STATE AND LOCAL ECONOMY. IMPORTANTLY, THE BILL DOES NOT REQUIRE ANY STATE TO MAKE ANY CHANGES, NOR DOES IT MANDATE A DIRECTION. IT PRESERVES THE RIGHT OF EACH STATE AND ITS CITIZENS TO DECIDE WHAT MAKES THE MOST SENSE FOR THEM.

MY BILL PLACES STATE INITIATIVES IN A FEDERAL CONSTRUCT BY REQUIRING NOTICE AND APPROVAL FOR ACTIVITIES WHICH ARE NOT ALLOWED UNDER FEDERAL LAW. THIS MEANS THAT THE COMPTROLLER OF THE CURRENCY AND THE BOARD OF GOVERNORS WILL CONTINUE TO SAFEGUARD THE SAFETY AND SOUNDNESS OF OUR COMMERCIAL BANKS AND PROTECT THE PAYMENT SYSTEM AT THE SAME TIME THAT THE BANKS DIVERSIFY THEIR PRODUCTS AND SERVICES. CLEARLY, FEDERAL STANDARDS HAVE TO BE MET, AS FEDERAL DEPOSIT INSURANCE STANDS BEHIND THESE INSTITUTIONS. IT IS POSSIBLE TO ENCOURAGE COMPETITION AND INNOVATION AND PREVENT EXCESSIVE RISK AT THE SAME TIME. THUS, THE BILL DOES NOT ADVOCATE ALLOWING BANKS TO ENTER ANY BUSINESS THEY CHOOSE. BUT, SENSIBLE ACTIVITIES WITH REASONABLE SAFEGUARDS SHOULD BE ENCOURAGED.

SHOULD EXPANDED BANK POWERS MEAN LESS EXAMINATION AND SUPERVISION? NO, NEW ACTIVITIES REQUIRE GREATER VIGILANCE ON THE PART OF REGULATORS. WE NEED MORE, BETTER TRAINED EXAMINERS TO DO THE JOB. TO THIS END, I INTRODUCED A BILL IN THE 99TH CONGRESS WHICH WAS PASSED BY THE HOUSE. THAT BILL WOULD HAVE LED TO AN ENHANCED SYSTEM OF EXAMINATION AND SUPERVISION FOR FEDERAL AND STATE REGULATORS. AT THE BEGINNING OF THE 100TH CONGRESS I REINTRODUCED THIS BILL IN THE HOUSE. I AM PLEASED THAT SENATOR RIEGLE SHARED MY CONCERN, AND INTRODUCED A SIMILAR BILL IN THE SENATE. I URGE YOU TO GIVE THIS ISSUE SERIOUS CONSIDERATION AS YOU EXAMINE THE STRUCTURE OF OUR FINANCIAL SERVICES INDUSTRY.

WHO BENEFITS FROM THIS BILL? WE ALL DO. CONSUMERS BENEFIT FROM INCREASED COMPETITION, AND THEREFORE, LOWER PRICES. THEIR INTERESTS SHOULD BE A TOP PRIORITY. COMMERCIAL BANKS BENEFIT BY BEING ABLE TO RECAPTURE SOME OF THEIR BEST CUSTOMERS WHO HAVE MOVED TO OTHER MARKETS. AND THIS IS NOT JUST A BILL FOR BIG BANKS. THE DIVERSITY AND FLEXIBILITY THAT WOULD ARISE FROM THIS APPROACH WOULD OFFER A MYRIAD OF CHOICES FOR SMALL BANKS AS WELL. BETTER PROFITS FOR BANKS MEAN STRONGER INSTITUTIONS AND A MORE SOUND SYSTEM. I AM NOT ADVOCATING EXCESSIVE RISK. I AM ADVOCATING REASONABLE ACTIVITIES COORDINATED WITH MEANINGFUL EXAMINATION, SUPERVISION AND REGULATION.

THANK YOU, MR. CHAIRMAN, FOR THIS OPPORTUNITY TO DISCUSS MY BILL WITH YOU AND YOUR COLLEAGUES. I FEEL THAT WE ARE AT A CROSSROAD OF OPPORTUNITY. THE TIME HAS COME TO TAKE CONTROL OF THE DESTINY OF OUR FINANCIAL INSTITUTIONS AND DEVELOP PUBLIC POLICY THAT MAKES SENSE IN LIGHT OF THE EXPLODING GLOBAL FINANCIAL SYSTEM AROUND US. WE CAN CONTINUE TO SIT BACK AND WATCH, WHILE THE WORLD CHANGES WITHOUT OUR INPUT. OR, WE CAN TAKE CONTROL AND BE SURE THAT CHANGE TAKES PLACE IN A RATIONAL LEGAL STRUCTURE, MEETING THE POLICY GOALS WE ESTABLISH. I WILL GLADLY ATTEMPT TO ANSWER ANY QUESTIONS YOU MAY HAVE.

SUMMARY OF H.R. 3063, THE DUAL BANKING SYSTEM ENHANCEMENT AND FINANCIAL SERVICES COMPETITIVENESS ACT

SECTION 1:

The short title.

SECTION 2:

This section contains the purposes of the Act which include: creating a more competitive financial services market; providing a framework for continued innovation in the delivery of financial services; improving the stability of commercial banks; increasing the global competitiveness of United States depository institutions; and lowering the cost of underwriting for municipal and private issuers of securities.

SECTION 3:

This section permits national banks to deliver the same products and services permitted under State law for state-chartered banks located in the same State as the national bank, providing that the Comptroller of the Currency has not prohibited the activity by regulation. The section provides for notice to the Comptroller of the Currency and authority to disapprove the proposed activity based on specific criteria. The Comptroller may require these activities to be conducted through a subsidiary of the national bank. The national bank may conduct the activities only in the State in which it is located and only to the same extent and in the same manner that State banks may engage in the activities under State law.

SECTION 4:

In a State where a bank holding company owns, controls or acquires a bank and State law permits State banks to engage in activities prohibited to a subsidiary of a bank holding company, a bank holding company may establish or acquire a nonbanking subsidiary to conduct those activities, subject to the conditions and limitations imposed under State law. These activities may be conducted only in that State and only to the extent and in the same manner that State banks may engage in the activities under the law of the State. The Board of Governors may prescribe appropriate capital and collateral requirements.

SECTION 5:

Bank holding companies which control banks in more than one State may maintain central administrative facilities to provide computational, operational, marketing, managerial and other similar support to their banks and subsidiaries conducting activities authorized under State law.

SECTION 6:

This section amends the Bank Holding Company Act to allow bank holding companies to own or acquire shares in a qualified securities company, which is defined as a registered broker or dealer which does not underwrite or

deal in long-term corporate debt or corporate equity securities, other than those eligible for a national bank, those issued by an investment company and those which represent pools of assets which a bank may originate. The section also allows a qualified securities company to underwrite, distribute or deal in any security in the United States, to a small degree, if that activity is undertaken in connection with a securities activity lawfully conducted principally outside the United States by the same qualified securities firm or its affiliate, on behalf of a United States client.

SECTION 7:

This section requires that a bank holding company notify the Board of Governors prior to establishing or acquiring shares in a qualified securities company under section 6 or a nonbanking subsidiary under section 4. The section provides for disapproval by the Board based on specific criteria.

Statement of
John P. LaWare
Chairman
Shawmut Corporation
before the
Committee on Banking, Housing
and Urban Affairs
United States Senate
Washington, D.C.
August 5, 1987

Mr. Chairman and members of the Committee, I appreciate the opportunity you have afforded me to appear today in order to describe to you a proposal for restructuring the financial services industry--the "Financial Services Holding Company Act." (FSHCA) This proposal was developed by the Association of Bank Holding Companies, and was endorsed by that Association's membership on May 21; it has subsequently been endorsed by the Bank Capital Markets Association and the Consumer Bankers Association.

I am appearing today not as a representative of any of these organizations, but as Chairman of Shawmut Corporation. My intent is to outline the FSHCA concept for you and then to respond to any questions you may have.

The Background

This Committee, with these hearings, has entered into one of the most difficult areas of public policy and, surely, one of the most important. In spite of the complexity of the subject, however, one overriding public policy concern stands out: the protection of insured deposits in federally-insured depository institutions. In my opinion, how well a particular proposal deals with this fundamental concern will determine in large measure how far it will advance in the congressional process.

Two subsidiary questions arise from consideration of the basic question of depositor protection. First, what degree of insulation of the insured deposits is appropriate? Second, assuming an optimal degree of insulation,

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what types of products and services may be offered by affiliates of an institution having insured deposits?

A further complicating factor is the inescapable fact that depository institutions are not operating in a vacuum. The degree of insulation imposed between depository institutions and their affiliates will be inversely proportional to their ability to compete. This raises a third subsidiary question: how effectively can insured institutions be protected from the competition that exists in the world around them? In other words, can they be kept alive in a protective cocoon granted by Congress? For example, it is conceivable Congress might create a model for the regulation and supervision of insured institutions that fails completely to take into account the vast array of competitors, both foreign and domestic, who are pursuing American consumers and businesses with innovative and lower-cost financial products and services.

In fact, those of us who manage bank holding companies would argue that today's Bank Holding Company Act, and its concomitant regulation and supervision, fit precisely this description of an outmoded, unsustainable "cocoon" environment. And we are determined to change that.

To avoid making the same mistake again, Congress must achieve a better balance between the insulation of insured institutions on the one hand, and the ability of these institutions and their affiliates to survive in a competitive environment. This implies that more, rather than less, risk will need to be tolerated in the system while at the same time provision is made to assure safety and soundness for depositors. (See Appendix "A")

The FSHCA

The FSHCA is an innovative idea designed to combine safety and soundness on behalf of depositors with the degree of regulatory and supervisory flexibility needed for financial institutions to survive in the revolutionary environment of today. This proposal breaks new ground--nothing like it has

ever been proposed in Congress. Those of us who support the idea recognize that it will require extensive debate, and there is no doubt that changes will have to be incorporated into the FSHCA as we go along. Nevertheless, I regard the FSHCA as a sound beginning, a major contribution to the debate this Committee has underway, leading toward the fundamental reform we believe is required.

In addition to a necessary emphasis on safety and soundness, the FSHCA also takes into account the logjam that has existed in Congress preventing enactment of amendments to the Bank Holding Company Act giving bank holding companies additional product and service flexibility. To help overcome the opposition that has prevailed, the FSHCA proposes to permit non-bank financial competitors to have an opportunity to own full-service commercial banks through a bank holding company. Actions by competitors in acquiring "non-bank banks" and unitary savings and loan holding companies attest to their desire to own federally-insured depositories. In exchange for the ownership of a full-service bank by our competitors, the FSHCA would authorize full entry by bank holding companies in the insurance, securities and real estate fields.

The Cornerstone

The FSHCA uses the bank holding company as the basic building block, rather than a bank, for two reasons. First, the bank holding company is now the dominant type of institution in banking. At the end of 1986, there were 6,465 bank holding companies, and they controlled 9,409 commercial banks out of the 14,000 operating today.

Second, the regulatory and supervisory experience of the Federal Reserve Board, in my opinion, can best be brought to bear in the new environment by retention of the bank holding company format. It makes sense to retain the safety net that now exists, and the expertise that now resides, in the Board and the Reserve Banks.

The FSHCA proposal is based on the premise that the transmission of any added risk to the insured institution can be controlled by requiring that the non-banking activity be conducted in a separate affiliate. To this end, we have included a new section 23B of the Federal Reserve Act similar to that contained in H.R. 27. This new provision will establish "arms length" standards for certain transactions between any bank owned or controlled by the Financial Services Holding Company (FSHC) and other affiliates.

I am well aware of concerns expressed by Chairman Volcker and others that, as a practical matter, it is difficult to provide absolutely effective insulation by legal means between a bank and its affiliates. This is one reason that I believe the bank holding company should be the cornerstone of the FSHC, since the protective mechanisms in place in that statute are the most sophisticated now available, and they include strong supervisory enforcement tools as well as extensive rules of conduct. With the addition of the protections of section 23B to that armory, I do not doubt that the balance I spoke of earlier between safety and soundness concerns and the competitive realities can be achieved.

The FSHCA does have another line of protection, however. The proposal accepts that not every conceivable line of business can safely be affiliated with an insured institution. The proposal supports a demarcation between "financial services" and "commerce." The question Congress must address is just where that line should be drawn. Clearly, I believe insurance, securities and real estate activities are "financial in nature," not "commerce." On the other hand, manufacturing and retailing are, in my opinion, "commerce."

(With regard to the "non-bank banks" allowed by H.R. 27, the FSHCA would also grandfather these institutions. The FSHCA would, similarly, not permit additional "non-bank banks" to come into existence.)

Functional Regulation

The FSHCA succeeds in making a useful distinction between supervision and regulation. Thus, the Federal Reserve Board would certify that the FSHC may operate, and the subsidiary companies of the FSHC would be regulated by their present regulators--federal or state. This approach--functional regulation--would apply to each subsidiary of the FSHC.

For example, the bank holding company would be regulated and supervised by the Federal Reserve Board and state bank supervisors; subsidiary banks would be regulated and supervised by their primary supervisor, either federal or state; savings and loan associations by the Federal Home Loan Bank Board and state savings and loan supervisors; insurance companies by their respective state insurance commissioners; and investment companies and securities companies by the Securities and Exchange Commission and state securities regulators. The virtue of these arrangements is that the existing regulatory and supervisory structure is left intact and will continue to be utilized. (The block diagram attached to my statement shows how the FSHC would look.)

While banks and bank holding companies would continue to be subject to the supervisory and regulatory oversight of the federal banking agencies, the Federal Reserve Board would have a new, ministerial function with regard to the FSHC. The Board would review notices from companies requesting certification or to acquire additional "financial in nature" firms. The actions proposed could go ahead unless the Board chose to notify the applicant, within 30 days, that the proposal did not meet the statutory standards. These provisions obviously aim at achieving that delicate balance between safety and competitiveness I discussed earlier.

Conclusion

In sum, the FSHCA offers an innovative mixture of features that include both traditional regulatory mechanisms and a new ministerial-supervisory role

for the Federal Reserve Board. Any company "financial in nature" may affiliate with a bank through a bank holding company and, at the same time, a bank holding company may use the same framework to own insurance, securities and real estate firms. By building on the experience of the Bank Holding Company Act, the FSRCA provides a flexible mechanism for financial services companies to serve businesses and consumers while retaining appropriate regulation and supervision of insured institutions.

Appendix

Among the papers that have addressed the question of risk are:

"Issues in Restructuring of the Financial Services Industry," speech by L. William Seidman, Chairman, Federal Deposit Insurance Corporation, to Society of American Business Editors and Writers, May 6, 1987, Washington, D.C.

"Nonbank Banks Are Not the Problem," by Catherine England, a policy analysis published by the Cato Institute, April 28, 1987.

"Bank Powers: Insulating Banks From the Potential Risks of Expanded Activities," report to the Chairman of the House and Senate Banking Committees by the General Accounting Office, April 1987.

"A Double Umbrella for the Banking System," by H. Robert Heller, Board of Governors of the Federal Reserve System, Speech to the Bank and Financial Analysts Association, 17th Annual Conference on Banking, New York, New York, March 26, 1987.

"Financial Market Structure: A Longer View," by F. Gerald Corrigan, President, Federal Reserve Bank of New York, paper released January 29, 1987.

"Taking the Dangers Out of Bank Regulation," by Robert F. Litan, The Brookings Review, The Brookings Institution, Fall 1986.

Statement of John P. LaWare, Chairman, Association of Bank Holding Companies, before the Subcommittee on Commerce, Consumer and Monetary Affairs, Committee on Government Operations, House of Representatives, Washington, D.C., September 18, 1986.

"Expanded Products and Services for Banking: the Public Policy Perspective," report by the American Bankers Association, September 1986.

Statement of John Shad, Chairman, Securities and Exchange Commission, before the Subcommittee on Commerce, Consumer and Monetary Affairs, Committee on Government Operations, House of Representatives, July 23, 1986.

Statement of Paul A. Volcker, Chairman, Board of Governors of the Federal Reserve System, before the Subcommittee on Commerce, Consumer and Monetary Affairs, Committee on Government Operations, House of Representatives, June 11, 1986.

Remarks by Robert L. Clarke, Comptroller of the Currency, before the Annual Meeting of the Association of Bank Holding Companies, Point Clear, Alabama, May 23, 1986.

"Financial Services: Consumers and the Separation of Banking and Commerce," paper by Sears Roebuck & Co., November 1985.

"Minimizing Regulation of the Financial Services Industry," by Robert J. Lawrence, Issues in Bank Regulation, Bank Administration Institute, Fall 1985.

"Deposit Insurance: Overhaul or Tune-Up?" by Thomas F. Huertas and Rachel L. S. Strauber, paper issued by Citicorp, July 30, 1985.

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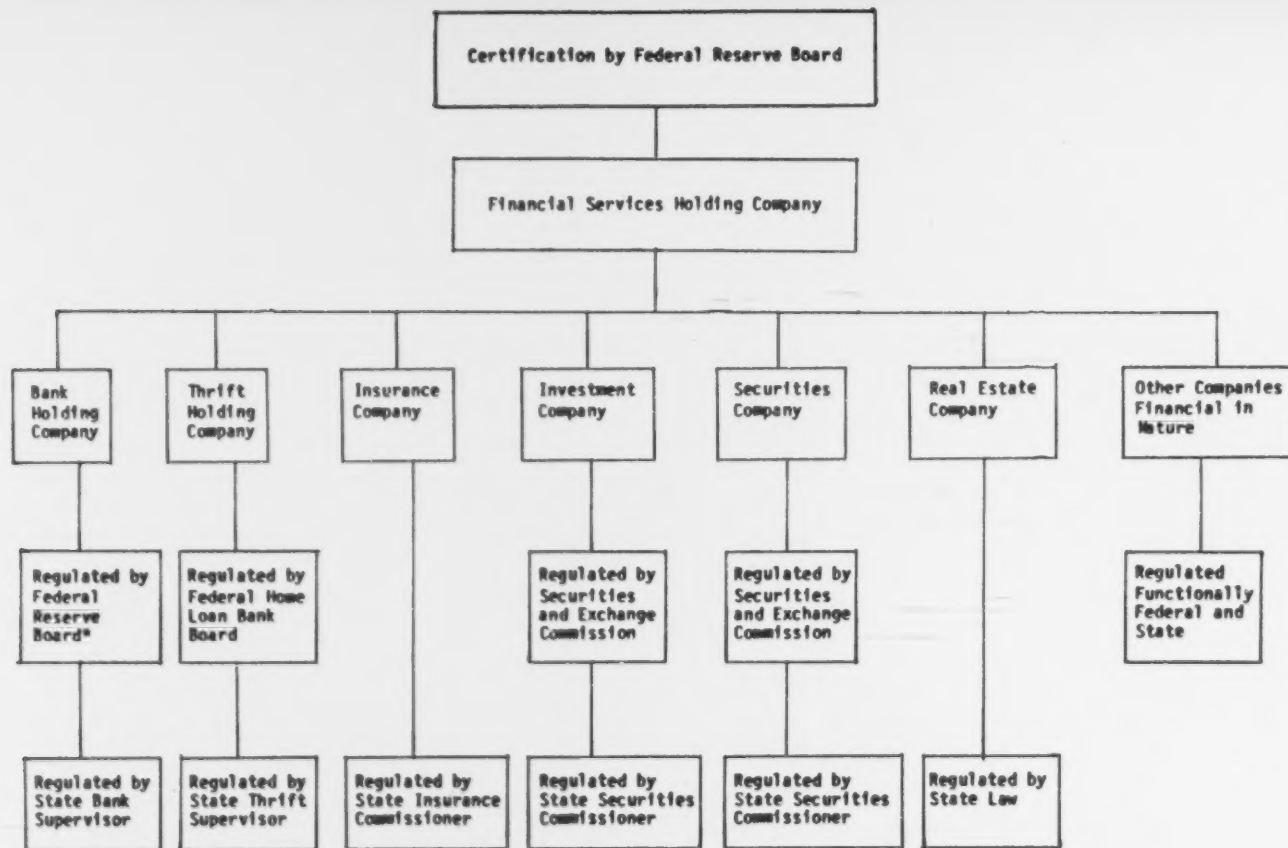
"The Emerging Shape of the Banking Business," by Hans H. Angermueller, speech to the Deutsche Bank Seminar, Frankfurt, F.R.G., June 27, 1985.

"Estimating Bank Risk," by Larry D. Wall and Robert A. Eisenbeis, article in Economic Review, published by the Federal Reserve Bank of Atlanta, May 1984.

"On the 'Specialness' of Banking," by Richard C. Aspinwall, article in Issues in Bank Regulation, Bank Administration Institute, Autumn 1983.

"Deposit Insurance in a Changing Environment," report by the Federal Deposit Insurance Corporation, April 15, 1983.

"Corporate Separateness as a Tool of Bank Regulation," Samuel Chase and Donn L. Waage, study prepared for the American Bankers Association, 1983.



*The Board would also continue its other regulatory responsibilities such as the payments mechanism, member banks, Edge Act Corporations, etc.

Association of Bank Holding Companies

August 5, 1987

A BILL

To authorize the creation of financial services holding companies,
and for other purposes.

Be it enacted by the Senate and House of Representatives of
the United States of America in Congress assembled,

SHORT TITLE

SECTION 1. This Act may be cited as the "Financial Services
Holding Company Act of 1988".

CERTIFIED FINANCIAL SERVICES HOLDING COMPANY

SEC. 2. A certified financial services holding company is
any company that:

(a) has been certified in accordance with the provisions of section 3 of this Act;

(b) has one or more subsidiaries that are bank holding companies, as those terms are defined in the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1841 et. seq.);

(c) has one or more subsidiaries that are separate from its bank holding company subsidiaries and are engaged only in one or more of the following:

- (1) managing, controlling and providing services for an insured institution as defined in section 408(a)(1) of the National Housing Act (12 U.S.C. 1730a(a)(1));
- (2) engaging in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities;
- (3) organizing, sponsoring, operating and controlling an investment company, and underwriting, distributing, and selling securities of any investment company, as such terms are defined in section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a-3), as amended;
- (4) acting as an investment advisor within the meaning of the Investment Advisors Act of 1940, as amended (15 U.S.C. 80b-2(11));

- (5) engaging in the business of insurance under the statutes of any of the fifty states, the District of Columbia, Guam or Puerto Rico;
- (6) engaging in real estate investment, development, and brokerage;
- (7) engaging in any activity permissible for a bank holding company under section 4 of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1843); or
- (8) engaging in any activity permissible for a multiple savings and loan holding company under section (c) of the Savings and Loan Holding Company Amendments of 1967 (12 U.S.C. 1730(a)(c));

(d) does not engage in any activities other than managing, controlling or providing services for the subsidiaries described in subsections 2(b) and 2(c) of this section;

(e) has insulated any bank or banks controlled by any of its bank holding company subsidiaries in accordance with the provisions of sections 23A and 23B of the Federal Reserve Act (12 U.S.C. 371(c)); and

(f) is not controlled, directly or indirectly, by any other company unless that company is primarily engaged in banking or other financial services outside of the United States or engaged solely in managing, controlling or providing services for a certified financial services holding company within the United States.

CERTIFICATION

SEC. 3. (a) Certification of a company as a certified financial services holding company is obtained by submitting a notice to the Federal Reserve Board.

(b) No later than 30 days following receipt by the Federal Reserve Board of the notice for certification, a company shall become a certified financial services holding company, unless within such 30-day period, the Board: (1) issues an order denying certification; (2) extends for up to an additional 30 days the period during which denial may be issued; or (3) notifies the company that it shall be a certified financial services holding company prior to the expiration of the 30-day period.

(c) The initial 30-day period may be extended for such additional 30-day period only if the Board determines that the company has not furnished all the information required to be submitted or that in the Board's judgment any material information submitted is substantially inaccurate.

(d) The form for the notice for certification shall be prescribed by the Board and shall be limited to information necessary to determine (1) whether the company's activities will be limited to those described in sections 2(c) and 2(d) of this Act, (2) whether the company is in compliance with the control limitations of section 2(f) of this Act, and (3) that any bank controlled by any of its bank holding company subsidiaries will be in compliance with the provisions of sections 23A and 23B of the

Federal Reserve Act. For purposes of these determinations, the Board shall find acceptable a statement signed by an appropriate senior officer of the company certifying that the company's activities will be limited to those described in sections 2(c) and 2(d) of this Act, that the company is not controlled, directly or indirectly, by any other company, other than as provided by section 2(f) of this Act, and that any bank controlled by any bank holding company subsidiary of such company will be in compliance with the provisions of sections 23A and 23B of the Federal Reserve Act (12 U.S.C. 371(c)).

(e) The Board may issue an order denying certification only if it finds that:

- (1) the company's activities will not be limited to those specified in sections 2(c) and 2(d) of this Act;
- (2) the company is controlled, directly or indirectly, by any other company, other than as provided by section 2(f) of this Act; or
- (3) the bank or banks controlled by any bank holding company subsidiary of such company will not be in compliance with sections 23A and 23B of the Federal Reserve Act (12 U.S.C. 371(c)).

(f) Within 3 days after a decision to deny certification, the Board shall notify the company in writing of such denial and shall provide a written basis for such denial.

ACQUISITIONS BY CERTIFIED FINANCIAL SERVICES HOLDING COMPANIES

SEC. 4. (a)(1) A certified financial services holding company may establish or acquire ownership or control of an additional bank holding company but only in accordance with the provisions of section 3 of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1842), as if it were a bank holding company.

(2) A certified financial services holding company may establish or acquire ownership or control of a savings and loan holding company, but only in accordance with the provisions of section 408(e) of the National Housing Act (12 U.S.C. 1730a(e)), as if it were a savings and loan holding company.

(b) A certified financial services holding company may establish or acquire ownership or control of any company engaged solely in one or more of the activities described in sections (2)(c)(2)-(8) of this Act if, within 30 days following the submission of a notice to the Federal Reserve Board, the Board does not disapprove the proposal or extend the period during which it may disapprove the proposal.

(c) The Board may disapprove a proposal only if the proposed acquisition or new activity would cause the company to fail to meet the activity limitations for a certified financial services holding company, as provided in sections 2(c) and 2(d) of this Act.

REPORTING REQUIREMENTS

SEC. 5. The Federal Reserve Board may periodically require reports under oath, in such scope and detail as it may determine, of a certified financial services holding company to keep the Board informed as to whether such company is in compliance with:

(a) the activity limitations of sections 2(c) and 2(d) of this Act;

(b) the affiliate transaction restrictions of sections 23A and 23B of the Federal Reserve Act (12 U.S.C. 371(c));

(c) the control provisions of section 2(f) of this Act; and

(d) the anti-tying provisions of section 106 of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1971).

PENALTIES

SEC. 6. (a) The Federal Reserve Board may exercise the enforcement authorities contained in subsections (b)-(n) of section 8 of the Federal Deposit Insurance Act (12 U.S.C. 1818(b)-(n)) if the Board finds that a certified financial services holding company is not in compliance with the activity limitations of sections 2(c) and 2(d) of this Act and the control provisions of section 2(f) of this Act. In exercising the authorities contained in subsections (b)-(n) of section 8 of the Federal Deposit Insurance Act (12 U.S.C. 1818(b)-(n)), the Board shall apply the standards and procedures set forth in those subsections

as if the certified financial services holding company were an insured bank.

(b)(1) If the Board finds that a company has failed to comply with:

- (A) the activity or control limitations of sections 2(c), 2(d), or 2(f) of this Act and has not in good faith substantially complied with any order or action issued pursuant to subsection (a);
- (B) the provisions of sections 23A or 23B of the Federal Reserve Act and has not in good faith substantially complied with any order or action issued pursuant to that Act; or
- (C) the provisions of section 106 of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1971) and has not in good faith substantially complied with any order or action issued pursuant to that Act.

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the Board by order, after opportunity for a hearing, may decertify the certified financial services holding company.

(2) A certified financial services holding company which has been decertified shall, within one year following the issuance of the decertification order, either divest all of its subsidiary bank holding companies or all the subsidiaries' activities not in compliance with the activity limitations of sections 2(c) and 2(d) of this Act. The Board is authorized, upon application by such a company, to extend the one-year period from

time to time as to such company, subject to conditions and limitations it deems appropriate, for not more than one year at a time, if, in its judgment, such an extension would not be detrimental to the public interest, but no such extensions shall in the aggregate exceed two years. For purposes of this subsection, the two-year period for compliance provided in section 4(a)(2) of the Bank Holding Company Act shall not apply.

(3) Any financial services holding company that has been decertified shall not be eligible to obtain a new certification as a financial services holding company in accordance with the provisions of section 3 of this Act for a period of three years following the decertification of such company.

JUDICIAL REVIEW

SEC. 7. Any party aggrieved by any order or notice of the Board under this Act, other than an order issued under authority of section 6(a) of this Act which shall be subject to the judicial review procedures set forth in subsections (b)-(n) of section 8 of the Federal Deposit Insurance Act (12 U.S.C. 1818(b)-(n)), may obtain a review of such action in the United States Court of Appeals within any circuit wherein such party has its principal place of business, or in the Court of Appeals in the District of Columbia, by filing in the court, within thirty days after the entry of the Board's order or notice, a petition that the order or notice of the Board be set aside. A copy of such petition shall

be forthwith transmitted to the Board by the clerk of the court, and thereupon the Board shall file in the court the record made before the Board, as provided in section 2112 of title 28, United States Code. Upon the filing of such petition the court shall have jurisdiction to affirm, set aside, or modify the order denying certification, notice of disapproval or decertification order of the Board and to require the Board to take such action with regard to the matter under review as the court deems proper. The findings of the Board as to the facts, if supported by substantial evidence, shall be conclusive.

BANK TRANSACTIONS WITH AFFILIATES

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SEC. 6. (a) The Federal Reserve Act is hereby amended by inserting after section 23A the following:

RESTRICTIONS ON TRANSACTIONS WITH AFFILIATES

"Section 23B. (a) A member bank, including its subsidiaries, that is controlled by a certified financial services holding company may engage in any of the following transactions only on terms and under circumstances, including credit standards, that are substantially the same as or at least as favorable to such bank or its subsidiaries as those prevailing at the time for comparable transactions with or involving other nonaffiliated companies or, in the absence of comparable transactions, those terms and circumstances that in good faith would be offered to, or would apply to nonaffiliated companies--

"(1) any 'covered transaction' as defined in section 23A of

the Federal Reserve Act with an affiliate;

"(2) the sale of securities or other assets, including assets subject to an agreement to repurchase to an affiliate;

"(3) the payment of money or the furnishing of services to an affiliate, under contract, lease, or otherwise;

"(4) any transaction in which an affiliate acts as an agent or broker or receives a fee for its services to the bank or any other person; or

"(5) any transaction or series of transactions with a third party (A) if an affiliate has a financial interest in the third party, or (B) if an affiliate is a participant in such a transaction or series of transactions.

"For purposes of this subsection, any transaction by a member bank with any person shall be deemed to be a transaction with an affiliate of such bank to the extent that the proceeds of the transaction are used for the benefit of, or transferred to, such affiliate.

"(b) A member bank, including the affiliates of such bank, that is controlled by a certified financial services holding company shall not publish any advertisement or enter into any agreement stating or suggesting that the bank shall in any way be responsible for the obligations of its affiliates.

"(c) A member bank, including any subsidiary of such bank, that is controlled by a certified financial services holding company--

"(1) shall not purchase as fiduciary any securities or other assets from any affiliate unless such purchases are

permitted under the instrument creating the fiduciary relationship, by court order, or by law of the jurisdiction under which the trust is administered; and

"(2) whether acting as principal or fiduciary, shall not knowingly purchase or otherwise acquire, during the existence of any underwriting or selling syndicate, any security, a principal underwriter of which is an affiliate of such bank, except that this prohibition shall not apply where the purchase of securities has been approved, prior to the time at which such securities are initially offered for sale to the public, by a majority of the directors of the bank who are not officers or employees of the bank or any affiliate thereof.

"For purposes of this paragraph, the term 'security' means a 'security' as defined in section 3(a)(10) of the Securities Exchange Act of 1934 (15 U.S.C. 78C(a)(10)); and the term 'principal underwriter' means any underwriter who, in connection with a primary distribution of securities, (A) is in privity of contract with the issuer or an affiliated person of the issuer, (B) acting alone or in concert with one or more persons, initiates or directs the formation of an underwriting syndicate, or (C) is allowed a rate of gross commission, spread, or other profit greater than the rate allowed another underwriter participating in the distribution.

"(d) For the purpose of this section--

"(1) the term 'affiliate' means an 'affiliate' as defined in section 23A of this Act (12 U.S.C. 371c) excluding a bank; and

"(2) the terms 'bank', 'subsidiary', 'person', and 'security (other than security as used in subsection(c)) have the same meaning given to them in section 23A of this Act (12 U.S.C. 371c).

"(e) The Board may prescribe rules and regulations to administer and carry out the purposes of this section, including rules or regulations to (1) further define terms used in this section; (2) exempt transactions or relationships from the requirements of this section; or (3) exclude from the definition of 'affiliate' in this section any subsidiary of a certified financial services holding company, if the Board finds such exemptions or exclusions to be in the public interest and consistent with purposes of this section.

"(f) The provisions of this section shall not be applicable to transactions subject to the exemption in subsection 23A(d) (12 U.S.C. 371c(d))."

(b) Section 18(j) of the Federal Deposit Insurance Act (12 U.S.C. 1828(j)) is hereby amended--

(1) by inserting "and section 23B" after "section 23A" at each place it appears in paragraph (1); and

(2) by inserting ",23B," after "23A" in paragraph (3)(A).

(c) Section 29(a) of the Federal Reserve Act (12 U.S.C. 504) is hereby amended by inserting "or 23B" after "23A".

AMENDMENTS TO THE BANK HOLDING COMPANY ACT

SEC. 9. (a) Section 2 of the Bank Holding Company Act of 1956

(12 U.S.C. 1841) is hereby amended:

(1) by revising subsection (c) to read as follows:

"(c)(1) Except as provided in paragraph (2), 'bank'

means--

"(A) an 'insured bank' as defined in section 3(h) of the Federal Deposit Insurance Act (12 U.S.C. 1813(h)); and

"(B) any other institution organized under the laws of the United States, any state of the United States, the District of Columbia, any territory of the United States, Puerto Rico, Guam, American Samoa, or the Virgin Islands that accepts demand deposits or deposits that the depositor may withdraw by check or similar means for payment to third parties and is engaged in the business of making commercial loans.

"(2) 'Bank' does not include--

"(A) a foreign bank solely by virtue of its having an insured or uninsured branch in the United States;

"(B) an insured institution as defined in section 408(a)(1) of the National Housing Act;

"(C) an organization that does not do business in the United States except as an incident to its activities outside the United States;

"(D) any institution that functions solely in a

trust or fiduciary capacity, if--

- "(i) all or substantially all of the deposits of such institution are in trust funds and are received in a bona fide fiduciary capacity;
- "(ii) no deposits of such institution which are insured by the Federal Deposit Insurance Corporation are offered or marketed by or through an affiliate of such institution;
- "(iii) such institution does not accept demand deposits or deposits that the depositor may withdraw by check or similar means for payment to third parties or others or make commercial loans; and
- "(iv) such institution does not--
 - "(I) obtain payment or payment related services from any Federal Reserve Bank, including any service referred to in section 11A of the Federal Reserve Act; or
 - "(II) exercise discount or borrowing privileges pursuant to section 19(b)(7) of the Federal Reserve Act;
- "(E) any credit union described in section 19(b)(1)(A)(iv) of the Federal Reserve Act;

"(F) any institution which--

"(i) engages only in credit card operations;

"(ii) does not accept demand deposits or deposits the depositor may withdraw by check or similar means for payment to third parties or others;

"(iii) does not accept any savings or time deposit of less than \$100,000;

"(iv) maintains only one office; and

"(v) does not engage in the business of making commercial loans;

"(G) an organization operating under section 25 or 25(a) of the Federal Reserve Act; or

"(H) an industrial loan company, industrial bank, or other similar institution which--

"(i) is chartered under the laws of a State which on August 4, 1987, had in effect or under consideration in its legislature a statute which required or would require such institution to obtain insurance under the Federal Deposit Insurance Act; and

"(I) does not accept demand deposits that the depositor may withdraw by check or similar means for payment to third parties;

"(II) has total assets of less than

\$100,000,000; or

"(III) is not acquired by a company; or

"(II) does not, directly or indirectly or through an affiliate, engage in any activity in which it was not lawfully engaged as of August 4, 1987."

(b) Section 3 of the Bank Holding Company Act of 1956 (12 U.S.C. 1842) is hereby amended by adding at the end of subsection (d) the following:

"Any company that controls a company that was established or acquired on or after August 4, 1987, and became a bank as a result of the enactment of the Financial Services Holding Company Act, and the establishment or acquisition of which would have been prohibited by this subsection had the definition of bank in such Act been in effect at the time of establishment, shall divest such bank within 180 days of the effective date of such Act."

(c) Section 4(a)(2) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(a)(2)) is hereby amended by adding at the end thereof the following:

"The two-year period referred to in this paragraph shall not apply to a company that becomes a bank holding company as a result of the enactment of the Financial Services Holding Company Act of 1988 and that acquired, between August 4, 1987, and the effective date of such Act, an institution that became a bank by virtue of the amendment to section 2(c) of this Act contained in the Financial Services Holding Company Act of 1988."

(d) Section 4 of the Bank Holding Company Act of 1956

(12 U.S.C. 1843) is hereby amended by adding at the end thereof the following new subsection:

"(f) A company that on August 4, 1987, controlled an institution that became a bank as a result of the enactment of the Financial Services Holding Company Act of 1988, or as a result of obtaining insurance under the Federal Deposit Insurance Act if required to do so by any state statute or regulation that is currently in effect or that may hereafter be enacted, and that was not a bank holding company on the date of enactment of the Financial Services Holding Company Act of 1988 shall not be regarded as a bank holding company solely by virtue of its control of such bank, provided such bank does not both accept demand deposits or deposits that the depositor may withdraw by check or similar means for payment to third parties and engage in the business of making commercial loans."

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(e) Section 2(a)(5) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(a)(5)) is hereby amended by adding at the end thereof the following new subsection:

"(G) No company which is a 'certified financial services holding company', as defined in section 2 of the Financial Services Holding Company Act of 1988, is a bank holding company by virtue of its ownership or control of a bank holding company."

(f) Section 3(d) of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1842(d)), is hereby amended by adding at the end thereof the following sentence:

"For purposes of this subsection, a certified financial services holding company shall be deemed to be a bank holding

company."

(g) Section 106(a) of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1971) is hereby amended by adding at the end thereof the following sentence:

"For purposes of this chapter, the term 'bank holding company' shall include any company which is a certified financial services holding company according to the provisions of the Financial Services Holding Company Act of 1988."

AMENDMENTS TO THE BANKING ACT OF 1933

SEC. 10. (a) Section 20 of the Banking Act of 1933 (12 U.S.C. 377) is hereby amended by inserting the following new paragraph after the first paragraph of such section:

"The provisions of this section shall not apply to affiliations between a member bank or bank holding company and a certified financial services holding company, including any of its subsidiaries, as defined in section 2 of the Financial Services Holding Company Act of 1988."

(b) Section 32 of the Banking Act of 1933 (12 U.S.C. 78) is hereby amended by inserting the following at the end of the first paragraph of such section:

"The provisions of this section shall not apply to any such interlocking relationships between a member bank or bank holding company that is an indirect subsidiary of a certified financial services holding company and such certified financial services holding company, or any affiliate thereof, as such terms are

defined by the Financial Services Holding Company Act of 1988."

AMENDMENTS TO THE NATIONAL HOUSING ACT

SEC. 11. (a) Section 408(a)(1)(D) of the National Housing Act (12 U.S.C. 1730a(a)(1)(D)) is hereby amended by inserting before the semicolon the following:

" , except that such term does not include a certified financial services holding company, as defined in section 2 of the Financial Service Holding Company Act of 1988".

(b) Section 408(e)(3) of the National Housing Act (12 U.S.C. 1730 a(e)(3)) is hereby amended by adding at the end thereof the following new sentence:

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"For purposes of this subsection only, a certified financial services holding company shall be deemed to be a savings and loan holding company."

DEFINITIONS

SEC. 12. For purposes of this Act--

"(1) the term 'affiliate' means an 'affiliate' as defined in section 23A of the Federal Reserve Act (12 U.S.C. 371(c)), excluding any subsidiaries of a bank holding company;

"(2) the terms 'bank', 'bank holding company', 'control', 'subsidiary', 'company' and 'Board' shall have the same meanings given to such terms in section 2 of the Bank Holding Company Act of 1956 as amended (12 U.S.C. 1841)."

August 5, 1987

Association of Bank Holding Companies

Financial Services Holding Company Act of 1988

Section-by-Section Analysis

Section 1--Short Title.

The bill is entitled the "Financial Services Holding Company Act of 1988".

Section 2--Certified Financial Services Holding Company.

A certified financial services holding company (CFSHC) is any company that satisfies six conditions: (1) the company owns a bank holding company; (2) the company engages through one or more subsidiaries separate from its subsidiary bank holding company in specified "financially-related" activities; (3) the company does not engage in any activities other than managing, controlling or providing services to its subsidiary bank holding companies or its subsidiaries engaged in permissible "financially-related" activities; (4) the company insulates its banks controlled by its bank holding company subsidiary in accordance with the provisions of Section 23A and new Section 23E of the Federal Reserve Act; (5) the company is "certified" by the Federal Reserve Board according to the procedures established in this Act; and (6) the company is not controlled by another company unless that company is primarily engaged in financial services outside of the U.S. or solely

engaged in managing, controlling or providing services for a financial services holding company.

The "financially-related" activities specifically permissible for a financial services holding company are the following:

- controlling a savings and loan association;
- underwriting or distributing securities;
- underwriting mutual funds;
- offering investment advice;
- engaging in insurance underwriting or brokerage;
- engaging in real estate development or brokerage;
- engaging in any activity permissible for a bank holding company; and
- engaging in any activity permissible for a savings and loan.

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By restricting the scope of activities permissible to a financial services holding company to "financially-related" activities, the bill modifies, but does not eliminate, the existing legal separation between banking and commerce. A company engaged in manufacturing or retailing, for example, could not qualify to be a CFSHC. On the other hand, an insurance firm, a securities firm, a savings and loan, or a real estate broker could qualify to be a CFSHC and control a bank holding company.

Each "financially-related" activity would be regulated according to existing law. For example, any securities activities would be regulated by the SEC, the NASD, the Commodities Future Trading Commission, etc. Similarly, any insurance activities would be regulated by appropriate state law and state insurance

commissioners.

Section 3--Certification.

Section 3 establishes the procedure for a company to become a CFSHC. The procedure utilizes a notice format. A company seeking to be certified must submit a notice to the Federal Reserve Board. The notice becomes effective after 30 days unless during that period the Board denies certification or extends the approval period for an additional 30 days. The Board may deny a notice only if it finds that the company's activities will not be limited to the list of "financially-related" activities provided in Section 2, that the company is controlled by another company that is not primarily engaged in banking outside of the U.S. or engaged solely in managing, controlling, or providing services for a CFSHC, or that the banks controlled by the bank holding company subsidiary of a financial services holding company will not be in compliance with the provisions of Section 23A or new Section 23B of the Federal Reserve Act.

Section 4--Acquisitions by Certified Financial Services Holding Companies.

Section 4 establishes the procedure for a CFSHC to establish or acquire ownership or control of subsidiaries in addition to its subsidiary bank holding company. A CFSHC seeking to establish or acquire an additional bank holding company must follow the procedures of Section 3 of the Bank Holding Company Act. A CFSHC seeking to establish or acquire ownership or control of a savings

and loan must follow the procedures of Section 408(e) of the National Housing Act. Finally, a CFSHC seeking to establish or acquire ownership or control of any other company engaged in one or more of the "financially-related" activities listed in Section 2 of the Act must submit a notice to the Federal Reserve Board. The Board has 30 days to either disapprove or extend the period for the notice. The Board may disapprove a notice only if the new acquisition or activity would cause the company to fail to meet the activity limitations for a CFSHC provided in Section 2 of the Act.

Section 5--Reporting Requirements.

Section 5 provides that a CFSHC must make certain periodic reports to the Federal Reserve Board. In the reports, which must be under oath, the CFSHC must indicate compliance with the activity and control limitations of Section 2 of the Act, the affiliate transaction restrictions of Section 23A and new Section 23B of the Federal Reserve Act, and the anti-tying provisions of the Bank Holding Company Act.

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Section 6--Penalties.

Section 6 sets forth penalties for violations of the Financial Services Holding Company Act.

Subsection (a) provides that the Federal Reserve Board may exercise all of the enforcement authorities contained in subsection (b)-(n) of Section 8 of the Federal Deposit Insurance Act if the Board finds that a CFSHC is not in compliance with the

activity and control limitations of Section 2 of the Financial Services Holding Company Act. Subsections (b)-(n) of Section 8 of the Federal Deposit Insurance Act authorize the imposition of cease and desist orders against the CFSHC, its officers and directors; orders to suspend or remove officers and directors of the CFSHC; and orders to impose civil money penalties against the officers and directors of the CFSHC. In exercising these authorities, the Board is directed to follow the standards and procedures found in subsections (b)-(n) of Section 8 of the Federal Deposit Insurance Act.

Subsection (b) authorizes the Federal Reserve Board to decertify a CFSHC if the Board finds that company has (1) failed to comply with the activity and control limitations of Section 2 of the Financial Services Holding Company Act, and has not in good faith substantially complied with any order or action issued pursuant to the Financial Services Holding Company Act; (2) failed to comply with the affiliate transaction restrictions contained in Section 23A or new Section 23B of the Federal Reserve Act, and has not in good faith substantially complied with any order or action pursuant to that Act; or (3) failed to comply with the anti-tying provisions in Section 106 of the Bank Holding Company Act, and has not in good faith substantially complied with any order or action issued pursuant to that Act.

The Board may decertify a CFSHC only pursuant to an order and after the CFSHC is afforded an opportunity for a hearing. A decertified CFSHC has one year to divest either its subsidiary bank holding company or the subsidiary or subsidiaries not in

compliance with the activity limitations of Section 2 of the Financial Services Holding Company Act. The one-year period may be extended for an additional year if in the judgment of the Board such an extension would not be detrimental to the public interest. Any CFSHC that is decertified may not be recertified for at least three years following its decertification.

This section does not impose penalties for violations of the affiliate transaction restrictions of Section 23A and new Section 23B of the Federal Reserve Act or the anti-tying provisions of Section 106 of the Bank Holding Company Act, as the Federal Reserve Act and the Bank Holding Company Act Amendments of 1970 already include penalties for violation of those provisions and a CFSHC would be subject to those provisions.

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Section 7--Judicial Review.

Section 7 sets forth the procedures for a party, subject to an order or a notice issued by the Federal Reserve Board pursuant to the Financial Services Holding Company Act, to obtain judicial review of such action. The judicial review procedures are patterned after those currently contained in the Bank Holding Company Act of 1956, which permit a review by a U.S. Court of Appeals. Orders and notices subject to the judicial review procedures contained in Section 7 include the certification notice procedure and any decertified orders. Enforcement actions such as cease and desist orders, civil money penalties, or suspension and removal orders would be subject to the judicial review procedures set forth in Section 8 of the Federal Deposit Insurance Act.

Also, violations of the anti-tying provisions of the Bank Holding Company Act and the affiliate transaction restrictions of Section 23A and new Section 23B would be subject to the judicial review procedures set forth in those Acts.

Section 8--Bank Transactions with Affiliates.

Section 8 amends the Federal Reserve Act to establish a new Section 23B, which imposes restrictions on transactions with affiliates. Section 8 is comparable to the language contained in S. 2851 which recently passed the U.S. House of Representatives and the U.S. Senate.

The new Section 23B would provide that any bank owned or controlled by a CFSHC may engage in certain transactions with other affiliates of the CFSHC as long as those transactions are on terms and under circumstances, including credit standards, that are substantially the same or are at least as favorable to the bank as those prevailing at the time for comparable transactions with affiliate companies.

Transactions covered by new Section 23B would be the following:

- (1) any loan or extension of credit to an affiliate;
- (2) the purchase of or an investment in securities issued by an affiliate;
- (3) the purchase of assets, including assets subject to an agreement to repurchase from the affiliate;
- (4) the acceptance of securities issued by an affiliate as collateral, security for a loan or an extension of credit

- to any person or company;
- (5) the issuance of a guarantee, acceptance or letter of credit including an endorsement or standby letter of credit on behalf of an affiliate;
 - (6) the sale of securities or assets, including assets subject to an agreement to repurchase to an affiliate;
 - (7) the payment of money or the furnishing of services to an affiliate under contract or lease or otherwise;
 - (8) any transaction in which an affiliate acts as an agent or broker or receives a fee for its services to the bank or any other person; and
 - (9) any transaction or series of transactions with a third party if an affiliate has a financial interest in the third party or if an affiliate is a participant in such a transaction or series of transactions.

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A bank owned by a CFSHC would also be precluded from publishing any advertisement or entering into any agreement stating or suggesting that the bank shall in any way be responsible for the obligations of any other affiliates owned by the CFSHC.

Finally, new Section 23B would provide that the securities activities between a bank owned by a CFSHC and other affiliates of the CFSHC be limited. Specifically, the bank would not be permitted to purchase as fiduciary any securities or other assets from any affiliate unless such purchases are permitted by the fiduciary relationship, by a court order, or by law of the jurisdiction under which the trust is administered. Also, the

bank, while acting as a principal or fiduciary, could not knowingly purchase or otherwise acquire, during the existence of an underwriting or selling syndicate, any security, a principal underwriter of which is an affiliate of the bank, unless the purchase of such securities have been approved prior to the time at which they are initially offered for sale to the public by a majority of the directors of the bank who are not officers or employees of the bank or any affiliate thereof.

This new Section 23B would follow the existing Section 23A in the Federal Reserve Act. Section 23A imposes other restrictions on transactions with affiliates. Section 23A requires that certain so-called "covered transactions" between a bank and other affiliates owned by a CFSHC are subject to percentage limitations and collateral requirements. Accordingly, a bank owned by its CFSHC may not engage in "covered transactions" with any affiliate of the CFSHC which exceeds 10 percent of the capital stock and surplus of the bank. "Covered transactions" are defined in Section 23A to include loans or extensions of credit to the affiliate; the purchase of or investment in securities issued by an affiliate; the purchase of assets from an affiliate; the acceptance of securities from an affiliate; and the issuance of a guarantee, acceptance or letter of credit on behalf of an affiliate.

The collateral requirements imposed by Section 23A require the bank to establish collateral ranging from 100-140 percent of the value of the covered transaction.

Any bank or any officer, director or employee or agent

thereof which violates the provisions of Sections 23A or new Section 23B would be subject to civil money penalties of not more than \$1,000 per day for each day during which the violation continues.

Section 9--Amendments to the Bank Holding Company Act.

Section 9 makes various conforming amendments to the Bank Holding Company Act which are required as a result of the creation of a CFSHC.

Subsection (a) redefines the term "bank" as it appears in the Bank Holding Company Act and in so doing closes the so-called nonbank bank loophole. This definition of a bank conforms with the language contained in H.R. 27, which recently passed the U.S. House of Representatives and the U.S. Senate. The term "bank" is redefined to mean any insured bank and any other institution organized under the laws of the United States that accepts demand deposits and is engaged in the business of making commercial loans. There are several exceptions to the definition of a bank.

Subsection (b) provides that any company that establishes or acquires a company that becomes a bank after the date of enactment of the Financial Services Holding Company Act must divest that bank within 180 days of the enactment of the Financial Services Holding Company Act.

Subsection (c) provides that a company that acquired a bank between the date of introduction and the date of enactment must divest that bank immediately.

Subsection (d) provides that companies that would become bank

holding companies as a result of the new definition of a bank would be grandfathered on the date of introduction of this bill. There are no activity or other restrictions imposed on grandfathered companies.

Subsection (e) provides that a company that is a CFSHC shall not be a bank holding company. In the absence of this provision any CFSHC would become a bank holding company and be subject to all the requirement and restriction provisions of that Act. As explained below, however, a CFSHC would be subject to two key provisions of the Bank Holding Company.

Subsection (f) provides that the CFSHC shall be considered to be a bank holding company for purposes of the interstate acquisition limitations contained in Section 3(d) of the Bank Holding Company Act. Accordingly, a CFSHC could not make interstate acquisitions of additional bank holding company subsidiaries unless such acquisitions were expressly authorized by a particular state.

Subsection (g) requires a CFSHC to be deemed a bank holding company for purposes of Section 106 of the Bank Holding Company Act Amendments of 1970. Section 106 contains anti-tying provisions. These provisions make it illegal for a bank to extend credit, lease or sell property of any kind, or furnish any service on the condition or requirement that a customer obtain additional credit from the bank.

Section 10--Amendments to the Banking Act of 1933.

Section 10 amends two provisions of the Glass-Steagall Act.

The amendments to Sections 20 and 32 would permit the affiliations and interlocking directorates between a bank holding company subsidiary of a CFSHC and any securities underwriting and brokerage activities engaged in by other subsidiaries of the CFSHC. Currently, Section 20 of the Banking Act of 1933 prohibits national banks and state member banks from affiliating with securities firms. Similarly, Section 32 of the Banking Act of 1933 prohibits interlocking directorates between securities firms and national banks and state member banks.

Section 11--Amendments to the National Housing Act.

Section 11 makes two amendments to the National Housing Act.

Subsection (a) clarifies that a CFSHC shall not be considered a savings and loan holding company. In the absence of this amendment, a CFSHC that owned a savings and loan would be subject to the provisions of the National Housing Act.

Subsection (b) provides that a CFSHC shall be considered a savings and loan holding company for the purpose of acquiring a savings and loan. Thus, a CFSHC must follow the procedures established in the National Housing Act for acquiring a savings and loan.

Section 12--Definitions.

Section 12 defines terms such as "affiliate," "bank," "bank holding company," "control," "subsidiary," "company," and "Board."

ASSOCIATION OF BANK HOLDING COMPANIES

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Volume 3
Number 7

July 1987

As indicated in last month's publication, the Association of Bank Holding Companies is proposing for congressional consideration a new concept, the "Financial Services Holding Company Act." The following questions and answers are designed to explain the provisions of the proposed legislation and the basis for its formulation.

I. Why is a "financial services holding company" needed?

For years, the financial services industry was rather neatly compartmentalized. Brokerage firms served one segment of the market, commercial banks another insurance companies another and thrift institutions yet another. Beginning in the mid-1970's, these clear-cut distinctions among the various providers of financial services began to evaporate. The invention of "NOW" accounts by the thrift industry in New England, and of money market funds by the securities industry, are two examples of the changes that took place in the 1970's. The unique and well-defined categories of business for banks and other financial institutions no longer fit. As these distinctions broke down, a new perception of what constituted banking began to emerge. This new perception involved a broader view of banking, and assumed that the financial services marketplace consisted of a variety of firms, some narrow in focus, others diversified, all competing for commercial and consumer business. In this new environment, "commercial banking" came to be seen not as a discrete line of business, but rather as a part of a broader financial services industry that included traditional banking and also insurance, mutual funds, securities and real estate brokerage and the like.

The changes in the marketplace for financial services that occurred in the 1970's generated policy responses within the Federal Government. In October 1981, then-Treasury Secretary Donald L. Regan presented the views of the Reagan Administration to the Senate Banking Committee favoring a major revision of the Bank Holding Company Act and the Glass-Steagall Act in order to allow the nation's financial system to "respond more efficiently to changes in the economic and competitive environments for the benefit of everyone." In March 1984, then-Chairman Paul A. Volcker of the Federal Reserve Board urged the same Committee to permit bank holding companies to undertake significant additional activities along the lines recommended earlier by Mr. Regan. While inconclusive debate ensued in Congress, non-bank financial firms were obtaining banking powers by acquiring so-called "non-bank banks." What was lacking was an overall legal structure to tie together the new and broader range of activities that were being conducted by banking and non-banking firms in the financial services marketplace.

The "Financial Services Holding Company Act" (FSHCA) proposed by the Association of Bank Holding Companies provides this structure by allowing any company "financial in

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nature" to own a bank holding company, and thereby own a full-service commercial bank or banks. At the same time, a bank holding company may utilize the same FSHCA framework to own insurance, securities and real estate firms. By building on the experience of the Bank Holding Company Act, the FSHCA provides a flexible mechanism for financial services companies to serve businesses and consumers while still allowing for appropriate regulation and supervision of the affiliated depository institutions.

The Financial Services Holding Company (FSHC) concept is therefore a product of market forces.

2. Would the FSHC proposal require major changes in the present system of delivery of financial services?

The creation of a FSHC is voluntary. There is no requirement for change in the present operation of existing financial institutions. A bank holding company may continue to operate under present law and regulation. Only when the management of a bank holding company desires full entry into the securities, real estate and/or insurance fields need it then opt for FSHC status. The same course may be followed by non-bank financial companies: only if the managements of these firms choose to own full-service commercial banks would it become necessary to form a FSHC.

3. How would a FSHC be structured vis-a-vis a bank holding company?

The bank holding company is the cornerstone of the FSHC, in recognition of the fact that today most banks are affiliated with bank holding companies. (At the end of 1986, there were 6,465 bank holding companies, and these controlled 9,409 commercial banks.) The FSHC would be a corporation owning a bank holding company and one or more other companies of a financial nature, all operating as separate subsidiaries.

4. What type of financial company or "companies of a financial nature" would be included under a FSHC? In other words, what activities would be authorized by the legislation?

In addition to bank holding companies, savings and loan associations would be included, as well as these activities: the issuing, underwriting, sale and distribution of securities; acting as investment adviser; operating mutual funds; engaging in the business of insurance, including underwriting and brokerage; and real estate development and brokerage. Any company engaged in any of these activities, or a combination of them, would be eligible to form a FSHC or affiliate with one.

5. How would risk be minimized so that the condition of a subsidiary would not be a threat to the stability of the bank?

The legislation provides for the insulation of the bank holding company and its insured bank subsidiaries from the FSHC through restrictions on transactions with affiliates. Transactions covered under this legislation would take place on terms that are substantially the same as, or no more favorable than, comparable transactions involving non-affiliated companies. This provision, together with current restrictions in the Federal Reserve Act, are intended as further protection under the FSHC. The overall aim of the FSHC is to insulate the insured depository from the activities of its uninsured affiliates, thereby protecting depositors' funds.

The CHAIRMAN. Thank you very much, Mr. LaWare, for a fine statement.

Congressman Carper, as I understand your proposal, you would allow a national bank or a bank holding company to engage in any activity allowed a State-chartered bank as long as the activity is engaged only in that State.

Now I'm not sure what you mean by the phrase "in that State." Do you mean the activity must be headquartered in that State or do you mean the services must be limited to residents of that State? For example, if a State allows State-chartered banks to engage in insurance underwriting, could a national bank or a bank holding company establish an insurance company chartered in that State but still sell policies to individuals or businesses outside the State?

NATIONALLY CHARTERED INSTITUTIONS

Representative CARPER. My view, sir, is that the nationally chartered institution that would be permitted to do business in that State could do business with the residents of that State, could not solicit business outside of that State by virtue of direct mail. For example, in Delaware, however, we used the Philadelphia media market for advertising. My view would be that a nationally chartered institution, for example, doing business in Delaware, could advertise in the Philadelphia media market but could not directly mail to people living outside of our State. In order to reach the residents of our State, we have to use a media market. We don't have any television. We have to use that market and we can appeal to those residents of our State through that kind of outreach.

The CHAIRMAN. It seems to me to be kind of a cousin to the South Dakota loophole.

Representative CARPER. No. We're talking about activities that could not be permitted unless they were also submitted to the Comptroller of the Currency and were approved by the Comptroller of the Currency. In our legislation, sir, the Comptroller of the Currency is given any number of criteria by which to disallow activities that might be contemplated by nationally chartered institutions.

Those criteria are listed in our legislation and if I could just very, very briefly mention those to you, first of all, the Comptroller of the Currency may simply prohibit by regulation certain kinds of activities. The Comptroller may elect to say that nationally chartered banks doing business in these States cannot do insurance underwriting. That may be the election of the Comptroller. The Comptroller may further say that nationally chartered institutions simply lacks managerial wherewithal to do certain kinds of activities and may not do them, even if they are permitted by his regulation.

The Comptroller may further say that certain kinds of activities may lead to undue concentration of power or resources and may disallow those activities as well.

So we still leave a considerable role for the Federal regulator even in these kind of activities.

The CHAIRMAN. Thank you, Mr. Carper.

CREATE A SECOND TIER HOLDING COMPANY

Mr. LaWare, the main feature of your proposal is to create a second tier holding company that would be able to control a bank holding company as well as financial affiliates not permitted under the Bank Holding Company Act.

Mr. LAWARE. Yes, sir.

The CHAIRMAN. However, all of the results of your proposal could also be accomplished by amending the Bank Holding Company Act to allow bank holding companies to engage in the activities on your list.

That being the case, my initial reaction to your proposal is that it seems to create another layer of bureaucracy without any corresponding benefits. Why not just amend the Bank Holding Company Act instead of creating another upstream holding company?

Mr. LAWARE. I think the idea is to give equal access. In other words, following along your suggestion, sir, the bank holding company would have to take the initiative of affiliating others with it—that is, securities companies or insurance companies or what have you. That might not be as attractive to an insurance company or a finance company as the opportunity to take the initiative in forming one of these financial services holding companies themselves, thereby being able to select, in addition to a bank holding company, whether they want to be affiliated with a real estate company or a finance company or what have you.

It's the idea of reciprocal access that we had in mind there.

The CHAIRMAN. Mr. Carper, your proposal allows the Comptroller of the Currency to issue regulations forbidding national banks from engaging in activities permitted State-chartered banks.

The bill does not seem to offer any guidance to the Comptroller for exercising this authority. I'm not sure, on the basis of my experience with Comptrollers of the Currency, that I would have that much confidence in the Comptrollers, not that I would criticize any particular one, but there's a competition in laxity, as you know, and there is a tendency for them to go pretty far.

What did you have in mind? What kind of activities would you expect the Comptroller to disapprove by regulation?

Representative CARPER. It's difficult to say because we don't know what administration that Comptroller is going to be working under. This administration's Comptroller might have a different idea than the Comptroller in the next administration, sir. And I don't really go into this with any preconceived notions. I agree with you that there's certainly plenty of reason to be wary of a situation where we give the Comptroller that kind of flexibility.

We may want to consider some measure in a bill like this in which we provide some guidance for the Comptroller. I wouldn't be uncomfortable with that approach. But there is something to be said for us trying to micromanage in the Congress, something to be said for leaving some discretion with the regulators, the people who do that kind of activity every day and not to tie their hands.

Let me just say that I'm sympathetic with the concern that you raised, but I don't want us to try to come up with a real specific

list if we can avoid it saying that these are the kinds of things you can permit and these are the kinds of things that you can't permit, Mr. Comptroller. I think we should provide that person with at least some discretion.

The CHAIRMAN. My time is up. Senator Garn was here and left and came back. He was here first. Senator Garn.

Senator GARN. I'm glad you noticed I was gone.

The CHAIRMAN. Of course. We always miss you.

Senator GARN. Thank you, Mr. Chairman.

STATES GUARD THEIR PREROGATIVES

Congressman Carper, in going over your proposal, I see some problems with it. I'm sure you are well aware of where I have been coming from over the years with respect to expanded powers and deregulation. If there is one thing I have learned after 13 years on this committee, it's the value of the dual banking system and how jealously the States guard their prerogatives. I think one of the major reasons that they have and it is attractive for some institutions to be State-chartered is that they feel they can gain some advantage over the national banks. Therefore, a State can say, to help our own smaller local institutions we will grant some additional powers that national banks do not have and, therefore, people have to make choices, and that's an incentive to maintain the dual banking system.

Do you have any concern that equalizing that out and allowing States to authorize the same powers for national banks as State-chartered banks, that there's no advantage for the State-chartered banks in working with their State legislators?

Representative CARPER. Actually, in the 5 years that I've been here in the Congress, if I've seen any changes in the value of a State charter, if anything, their value has been enhanced. If anything, the value of a national charter or being a national bank holding company, the value has been diminished.

What my bill would do is to try to reverse a little bit of that trend. I don't believe that it would do damage or violate the dual banking system. I think it still leaves us very much with a State and a Federal system that are closely working together in terms of powers that are authorized by the State that these nationally chartered institutions could perform and also maintain the close oversight of the regulators, either the Board of Governors or the Comptroller of the Currency.

Senator GARN. Does it concern you that it would create a hodge-podge of different powers throughout the country? That's also one of the things that we have had difficulty with. With Congress' unwillingness to act over a long period of time, decisions have been being made by State legislators, regional banking situations, and even more importantly the courts. Are we simply adding to that hodge-podge of different types of rules and regulations?

Representative CARPER. I agree with you that what we have now is, to an extent, a hodge-podge. But we also have a situation which permits the States to act as laboratories, for us literally to do experiments, to permit banks to perform certain kinds of activities, to have certain kinds of powers, and to make sure that those aren't

abused and make sure that they can be properly regulated to the benefit of consumers and our citizens.

The proposal submitted by my friend here to my left really takes us a great deal further down the road than personally I am prepared to go just now. I think he has a good idea. It's one that attracts me very much. But to go from where we are today to quite as far as he has suggested, I think we need some interim steps, some measured steps. And what I think what I've proposed here is that measured step, that interim step, to enable to try it on for size to see how it works, to experiment to an extent in these State laboratories, I think with the dual banking system still in place and not violated, and to then contemplate, if this works, what should our next appropriate step be.

Senator GARN. Well, I would agree with you the States have provided some useful functions as a laboratory, but what has normally happened is that once the States have come up with something that appears to be very good in the marketplace it expands. It has been accepted. The whole regional banking concept came out of States. NOW accounts came out of the States. A lot of things that have happened came from the States without this particular mechanism.

I would have one other concern beyond the issue of the hodge-podge. To follow up what the chairman was talking about in terms of the Comptroller, I've seen several different comptrollers over the years. They come in with different philosophies on how financial institutions should be managed. I would be concerned that you have a State decide, "All right. This is what we want to do within our State." Then you get a Comptroller that says, "No, I don't agree with this." You have given him a great deal of power to override. I really see a great deal of confusion. It's not your intent obviously to create that. I understand where you are coming from and agree with what you are trying to accomplish.

I am really concerned that you have set up a series of situations here that add to that hodge-podge an even greater confusion than we have now, even though that is not your intent.

My time is up.

The CHAIRMAN. Senator Shelby.

Senator SHELBY. Thank you, Mr. Chairman.

I want to welcome my former colleague in the House and friend, Tom Carper. I want to commend you for your proposal. I have talked in this committee since coming to the Senate about an evolution of the banking services, that we can't go backward and we should go forward. But this concept looks like some of us in the South call the "whole hog" concept; you want it all in this rather than a part of it.

I have advocated that we ought to make public policy here in the Banking Committee rather than have the marketplace make it for us or other institutions like the Federal Reserve. On the other hand, it looks to me like this is going to the real supermarket. I was thinking of Mr. LaWare, who is the chairman of a large bank holding company in Boston—is that where it is?

Mr. LAWARE. Yes, sir.

Senator SHELBY. I believe your statement here was, "Clearly, I believe insurance, securities and real estate activities are financial

in nature and not commerce." Well, there's probably going to be a lot of dispute about that, whether insurance or especially real estate is financial in nature.

I can see mutual funds, bank underwriting and other things being a natural evolution, but it looks to me like real estate is not and would be a big risk factor for banks.

Mr. LAWARE. I think the distinction, Senator, is between——

Senator SHELBY. I'd like to hear your comment.

Mr. LAWARE [continuing]. Manufacturing and retailing versus financial kinds of activities.

Senator SHELBY. But how is real estate financial?

Mr. LAWARE. Well, building and management of real estate, I agree, is not. But the development or the brokerage of real estate is.

Senator SHELBY. Well, the financial end of it, like mortgage banking and so forth, that's clearly financial. But I'd ask you the question, is real estate as much of a financial issue or should be defined as financial such as mutual funds or the underwriting of securities, the issuance of corporate paper? I'd say that's getting in the gray area. That's my opinion.

Mr. LAWARE. Well, real estate brokerage, it seems to me, is a very low risk, low capital intensive, purely financial transaction in which a service is provided.

Senator SHELBY. But the building and development of real estate is high risk.

Mr. LAWARE. Development, may be more questionable, and that's what I was getting at when I said I think it is——

Senator SHELBY. You just look at the office vacancies around the country.

Mr. LAWARE. Yes.

Senator SHELBY. Just look at the commercial vacancies around the country.

Mr. LAWARE. Yes, indeed, most of which have been financed by banks in one fashion or another.

Senator SHELBY. And you can also look at what we have had to right here in this committee, FSLIC, which the chairman, through his leadership, has tried to deal with and is dealing with as a big first step, as I call it, because a lot of the savings and loans that are in trouble have been speculating in the real estate field. I wouldn't say that's the whole problem and I would wonder, if we were to pass into law a proposal such as proposed by Congressman Carper, what would be the ultimate risk there? I have no quarrel with mutual funds, with underwriting corporate paper. I think we ought to revisit Glass-Steagall. But when you're getting into real estate, I think you're getting into the gray area.

Representative CARPER. Let me just say I'm happy to see you here today sitting up there.

Senator SHELBY. Thank you.

STATES SET LIMITS ON VARIOUS ACTIVITIES

Representative CARPER. My approach is not a whole hog approach. As I said earlier, I think it's a measured approach. Limits are set. For State-chartered institutions the States set the limits on

the kinds of activities that they can be involved in. Any nationally chartered bank which is doing business in that State is limited to what activities a State legislature and State government has already said are appropriate for the citizens for the activities of the banks in that State. Any bank holding company that might own a bank or a subsidiary within that same state is further limited by that State's activities.

Senator SHELBY. But you're not having any uniformity here and I think the chairman alluded to the South Dakota problem that we have had throughout the banking industry, or a lot of us think it's a problem anyway—

Representative CARPER. I think it's a problem, too.

Senator SHELBY. If you say, well, we're going to pass a law that's going to let whatever the States do is okay, where is the uniformity?

Representative CARPER. Here's what we've tried to do and actually this is the language in the bill, sir. It says, "These activities may be conducted only in that State and only to the extent and in the manner that State banks are already engaging in those activities under the laws of the State." We try to avoid the South Dakota loophole by making that stipulation throughout the bill. Activities may be conducted only in that State and only to the extent that State-chartered institutions are already conducting them.

Senator SHELBY. My time is up, but I do commend you for your proposed legislation. I think it goes a bit far but maybe you've got to open it up a long way to get part of the way.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Shelby.
Senator Bond.

Senator BOND. Thank you, Mr. Chairman. I join with my colleagues in welcoming these witnesses and thanking them for their very informative testimony on comprehensive financial institution proposals.

Certainly this subject is central to our discussions of expanded powers. If this committee cannot come up with a structure that effectively insulates the insured depository from other lines of business, then there isn't any point in discussing which powers banks should be given. On the other hand, if questions of conflicts of interest and tie-ins can be resolved to our satisfaction, then I see no reason why we should not move ahead with comprehensive legislation.

You gentlemen have made significant contributions to our deliberations on the issues. The approaches are somewhat different. I particularly appreciate, Mr. LaWare, your sharing the fine work done by the Association of Bank Holding Companies. And, as a former Governor, I can certainly see the merit in letting the State legislatures and executives settle these issues and I commend you, Congressman Carper, for coming to discuss this proposal with us.

I, too, have seen the difference in the kinds of bids we have on State GO bonds in the State of Missouri versus the revenue bonds on which banks could not bid. I would just add as a cautionary note that perhaps the somewhat greater risk may have influenced the difference in the rates that we were able to get at almost simultaneous auctions, at least in our State.

CURRENT LAW IS DEFECTIVE

There is one major question I would like you to deal with, Congressman. We had very thought provoking testimony from Mr. Mayer before this committee. In his testimony he stated that Congress really must preempt the States out of the asset control area, and he quotes Mr. Richard Pratt who he says is an absolutely free market man as saying that current law is defective in that it gives the States the power to put their hands in the Federal treasury by approving all sorts of high risk activities by S&L's and banks they charter and Washington insures. He says, "Obviously, any extension of bank holding company powers must be calculated to minimize the chances of losses from such activities."

Would you comment on how that thought might apply to your proposed legislation?

Representative CARPER. An important provision of my proposal, Senator, is that the Board of Governors of the Federal Reserve would have oversight in terms of determining what kind of activities can still be conducted by bank holding companies owning banks or subsidiaries in States in conducting business or broader activities within those States. There's a clear, well defined role for the Board of Governors to play in regulating those activities.

Further, for nationally chartered institutions doing business in States, the Comptroller of the Currency is given the authority to, by regulation, prohibit certain kinds of activities and to further determine by institution whether or not that institution is capable of providing those activities or participating in them. We don't give a blank check to the States. We don't simply turn to the States and say, "You do as you wish and these nationally chartered institutions or subsidiaries of bank holding companies can do the same." We continue a strong, close oversight and strong supervision by the appropriate regulator and I think that's needed.

Senator BOND. How about the question of banking and commerce, the mixing of the two? If the States said, "Sure, you can have a bank and a manufacturing company and a retail outlet all together in one group," would your proposal permit that?

Representative CARPER. Only if the Board of Governors of the Federal Reserve thought that there was an appropriate permissible activity, only if the Board of Governors of the Federal Reserve Board or the Comptroller of the Currency felt that the bank holding company or the nationally chartered bank was capable of handling those activities, that they would not do potential damage to the banks that are involved.

Senator BOND. Mr. LaWare, I might turn to you and ask for you to explain to me just why you think that the banking and commerce functions should be kept separate.

Mr. LAWARE. Well, I think the principal reason is the question of concentration of economic power. The banking and the financial services industries are deconcentrated. For example, Citicorp, which is the largest bank in the United States and 18 times the size of my company, accounts for less than 3 percent of the deposit structure of the United States, whereas the automotive industry and several others are highly concentrated.

Senator BOND. But they are in the nonbank banks?

Mr. LAWARE. That's right, and I don't see any way we can take them away from them. That competition doesn't bother me, as long as they are now constrained in terms of H.R. 27.

Senator BOND. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Bond.

Mr. LAWARE. Mr. Chairman, may I just make two comments on Congressman Carper's proposal?

The CHAIRMAN. Yes, sir.

BRANCHING RULES

Mr. LAWARE. The first is that there's a good precedent for this in the branching rules. As you recall, national banks were allowed to branch in those States where State law permits State-chartered banks to branch. And that has not caused any major problem over the years.

The second thought I have is that if the States move to liberalize a lot of things and national banks are not allowed to participate, there may be a flight from the nationally chartered system, a conversion of large number of banks to State charters, and that may not be in the public interest.

Those are just two comments which I wanted to make. It's a very imaginative proposal.

The CHAIRMAN. I have to leave in a very few minutes to go to the floor, unfortunately, but I have a couple more questions I'd like to ask.

Mr. LaWare, the practical effect of your proposal is to allow banking organizations to enter the securities, insurance, real estate businesses, and vice versa. Of course, these three industries have been vehemently opposed to bank entry into their business.

Whatever the substantive merits of your proposal, as a political matter, what makes you believe that Congress could overcome the entrenched opposition of three separate and powerful industries that would occur if we were to move on the legislation? You know there are more insurance agents in New Jersey alone than there are banks in the entire country? It would be pretty hard to push those fellows around even if one wanted to.

Mr. LAWARE. And I'm sure they would all be up here marching around with this kind of a proposal.

The CHAIRMAN. I'm sure they would.

Mr. LAWARE. I must say that I think there is some indication that insurance companies and securities companies are becoming more interested in this proposition. One reason is the opportunity to participate in full service banking, not in the limited service banks that some of them already have but in a full service banking operation.

The second is that in many ways—and I'm not being perjorative about the independent insurance agents—far be it from me to do that—but the distribution of insurance through the agency system versus more direct distribution is not a very efficient way to go. And I think more insurance companies are coming to direct mail and direct sale of insurance policies because of that.

So this may be a more seductive proposal to at least insurance company managements in the future than it has been in the past.

The CHAIRMAN. Well, it may be but we will just have to see. If they come in and knock on our door and say, "We are all for the LaWare proposal," I'll be astonished.

Mr. LAWARE. Well, I'm afraid they've got us outnumbered, Senator.

The CHAIRMAN. Mr. Carper, while your proposal allows the Comptroller of the Currency to forbid an activity by regulation if carried out by a national bank, it does not seem to provide comparable authority for the Federal Reserve no matter how risky the activities might be.

Shouldn't the Federal Reserve have the authority to disallow an activity for bank holding companies if it finds the activity poses an undue amount of risk on the holding company and the bank subsidiary?

FED HAS A CASE-BY-CASE AUTHORITY

In answering Senator Bond's question earlier, you indicated that the Federal Reserve has a case-by-case authority, but I'm talking about a regulatory authority across the board. You don't seem to give that to the Federal Reserve, while you do provide it for the Comptroller.

Representative CARPER. Let me just refer to page 7 of the bill. What we do say is that the Board has the authority to set certain minimum capital or collateral requirements with respect to activities that are engaged in by the bank holding company's nonbanking subsidiary.

The CHAIRMAN. But they can't prohibit an activity per se? You can provide minimum capital and collateral and so forth, but they can't prohibit it across the board.

Representative CARPER. We say to the Comptroller of the Currency that you may by regulation prohibit certain kinds of activities. In the legislation, I don't believe we say that for the Federal Reserve, but we do give them the authority to set strict minimum capital standards and collateral standards which, if met, would permit the institution to go ahead and practice those activities.

The CHAIRMAN. Supposing the State for some reason—Senator Hecht isn't here—says that the bank can engage in gambling activities. Does that mean the Fed couldn't prohibit it?

Representative CARPER. Let me just say the legislation further says that the Board of Governors may prescribe "such other regulations as may be necessary or appropriate to carry out the provisions of this subsection." That's fairly broad and general language which I think could be construed to meet the concern that you raise.

The CHAIRMAN. If that's your intent, why don't you make it specific?

Representative CARPER. We could.

The CHAIRMAN. It might improve it.

Representative CARPER. Yes, and I think the purpose of these hearings is to get those kinds of ideas.

The CHAIRMAN. Now I'm going to have to leave and I'm going to ask Senator Bond, since Senator Shelby is also about to leave, to

6. How would a FSHC be certified and regulated?

Certification of a FSHC would be obtained by submitting a notice to the Federal Reserve Board stating that the company's activities will be limited to those provided for by the Act and that insured depository institutions affiliated with the FSHC will be in compliance with the provisions of the FSHCA restricting transactions with affiliates. Following certification by the Federal Reserve Board, which would be an automatic process so long as the terms of the statute were met, the activities of the FSHC would be regulated on a functional basis. The bank holding company would be regulated and supervised by the Federal Reserve Board and state bank supervisors; savings and loan associations by the Federal Home Loan Bank Board and state savings and loan supervisors; insurance companies by their respective state insurance commissioners; and investment companies and securities companies by the Securities and Exchange Commission and state securities regulators.

7. Are companies of a financial nature owning "non-bank banks" covered by the proposed legislation?

The legislation defines a bank as one that is federally insured. Existing "non-bank banks" would be grandfathered. However, companies financial in nature would be eligible, through the FSHCA, to acquire full-service commercial banks, and may be expected to convert their "non-bank banks" to full service banks over time.

8. Are companies outside the scope of "financial in nature" covered by the Financial Services Holding Company Act?

Companies outside the scope of "financial in nature" are not covered by the FSHCA. This means that a firm in commerce generally—e.g., retailing, manufacturing or publishing—would not be eligible to form an FSHC in order to own a full-service commercial bank. The FSHCA broadens the scope of financial businesses that may be affiliated with insured commercial banks, but it retains a distinction between financial services and commerce generally.

9. Some commercial companies own "non-bank banks." What would happen to these institutions under the FSHCA?

Under the FSHCA, a commercial firm could retain its "non-bank bank," but it could not convert the bank to a full-service commercial bank by utilizing the FSHC.

10. Would the enactment of the FSHCA affect interstate banking laws?

The enactment of the FSHCA would have no effect on interstate banking laws. They would remain as they are today.

11. One of the arguments used against broader authority for bank holding companies is that the managements of these companies will coerce customers to buy products and services they do not want. For example, an insurance policy may be tied to the extension of an automobile loan. Won't the FSHCA simply encourage such coercion?

An adequate framework of consumer protection has been built into the Bank Holding Company Act. "Tying" of products, by making it mandatory to purchase one product in order to obtain another, is illegal. Legitimate consumer concerns regarding the sale of a

variety of financial products and services via the FSHC can be dealt with as well. There is no need to prohibit such activities.

In fact, the cross marketing of financial products and services lies at the heart of the FSHC concept. Cross marketing, however, does not imply coercion. It does imply increased convenience, greater efficiency and the potential for considerably lower costs to consumers. In combining various products and services, the financial services industry is simply following in the path of the retailing industry which, through department stores and supermarkets, accomplished the same thing years ago. As noted earlier, the changes are, and have been, consumer driven.

Anti-competitive interests will always attempt to block market improvements by using arguments against change. Nonetheless, these anti-competitive arguments should not obscure the fact that consumers will benefit from the diversification and competition occurring in all segments of the financial services business.

12. Will the creation of FSHC's lead to an undesirable concentration of financial resources?

The FSHC proposed by the Association reflects the view that commercial firms such as General Motors or Ford should not be affiliated with a bank holding company. We believe that if such affiliations were permitted, they could lead to an undesirable concentration of economic resources.

With regard to companies "financial in nature," each industry--banking, securities, insurance and real estate--have different levels of concentration and different yardsticks by which concentration is measured. It is not at all clear that, taken either separately or together, concentration in these industries should be considered a problem.

In banking, for example, the industry is noteworthy for its lack of concentration. Moreover, there has never been agreement among academicians about what should constitute a true measure of concentration in banking. Should it relate to deposit-taking or to the granting of commercial or consumer credit? If deposits are considered as the criterion, should foreign and domestic deposits be included, and should the deposits in thrift institutions and such near-deposits as money market funds be included? Citicorp, for example, as the nation's largest bank holding company, has less than two percent (2%) of the domestic deposits of all U.S. banks; if deposits of thrift institutions are included, this number drops to about 1.35%. Thus, there is no evidence that the growth of bank holding companies has led to adverse concentration in the national banking market. It is relevant to note that the number of commercial banks, 14,200, is the same as it was ten years ago. Even with the spate of mergers that have occurred, many new banks have been formed as well. (These 14,200 banks operate 56,000 separate offices.) Concurrently, foreign banks not subject to many of the restrictions placed on American banks continue to garner a growing share of U.S. banking assets.

Using yardsticks applicable to their industry, the securities and insurance businesses turn out to be much more heavily concentrated. For example, the ten largest life insurance companies have 43 percent of the industry's assets. Nevertheless, with thousands of firms in this industry, and with relatively easy entry, the life insurance industry need not be considered overly concentrated. With regard to the securities industry, various criteria may be used, and some show significant concentration. For example, the New York Times reported that the top ten corporate underwriters accounted for 91% of all volume of new corporate issues in 1985; by a different measure, the Securities Industry Association reported that in 1984 the top ten firms' total underwriting revenues came to 48% of the total for the industry.



By eliminating artificial barriers to entry of bank holding companies into other financial services activities, and allowing for reciprocity, the FSHC can promote increased competition, which should be the guiding principle for antitrust policy in any industry. And because commercial and manufacturing firms would not be allowed to establish FSHC's, there is no possibility that corporate combinations along the lines of Japanese or German models could emerge.

13. What are the advantages of the FSHC structure to smaller institutions?

There are advantages to the FSHC structure to institutions of all sizes. First, this flexible structure would be an option available to all institutions. It is not necessary for an institution to be a particular size to take advantage of the opportunities that the FSHC structure provides. Second, even though an institution may not choose to engage in the expanded securities, real estate or insurance activities that would be made available under the FSHC concept, it nonetheless would find increased flexibility to conduct its existing businesses. Any bank holding company could benefit from reorganizing its existing nonbanking businesses into the FSHC structure so as to utilize the advantages of the system of functional regulation it provides.

Significant Congressional, Federal Agency, Judicial
and Other Developments Affecting Bank Holding Companies

- **Supervisory and Application Fees.** The Federal Reserve Board has published for comment a revised proposal to charge assessments and fees for certain supervisory activities and applications. 32 Federal Register 21564 (June 8).
- **Interstate National Bank Acquisition.** The U.S. Court of Appeals for the D.C. Circuit has upheld the decision of the Federal Reserve Board approving the application of First City Bancorporation of Texas, Inc., to acquire a credit card bank in South Dakota. Independent Community Bankers Association of South Dakota v. Board, No. 85-1496 (June 5).
- **House Banking Reports Truth in Savings Bill.** The House Banking Committee approved a truth in savings bill sponsored by Representative Richard H. Lehman (California). The bill, H.R. 176, deals principally with the advertisement of interest rates on savings accounts. It also requires that interest be computed on the full amount of the principal contained in an account.
- **SEC Chairman Nominated.** The President has nominated David S. Ruder to become Chairman of the Securities and Exchange Commission.
- **Last Edition of Commercial Paper.** On June 22, the U.S. Supreme Court denied the petition by the securities industry requesting review of a lower court opinion permitting Bankers Trust Company to place third party commercial paper. SIA v. Board of Governors, No. 86-1429.
- **Expansive Branching Decision Upheld.** Also on June 22, the U.S. Supreme Court denied the petition by the Mississippi Department of Banking requesting review of a lower court opinion providing national banks expansive in-state branching rights. The lower court had found that the Comptroller of the Currency correctly ruled that national banks may branch throughout the state on a basis comparable to state savings associations. Department of Banking v. Clarke, No. 86-1375.

take over the chair. He's a Republican, but he's a Republican I trust. [Laughter.]

The CHAIRMAN. There are not many of those.

Senator SHELBY. Mr. Chairman, I'm going with you to the floor, as you know.

The CHAIRMAN. Fine. Senator Bond will take over and can conclude the hearings.

Senator BOND. I'm honored, Mr. Chairman, and I assure you I won't try to expand that power too greatly.

Gentlemen, just one or two further final questions.

SECURITIES POWERS

Mr. Carper, you've provided specific authorization for securities activities in your proposal, but leave the other powers for the States.

Why do you think that we should specifically say securities powers?

Representative CARPER. I believe that securities powers are powers that are already closely held by banks. The idea of underwriting tax exempt revenue bonds is, as we've agreed, very closely related to underwriting tax exempt general obligation bonds.

The activity of underwriting mortgage-backed securities is I think quite similar to providing mortgages for homes. The activities that involve underwriting a mutual fund are not all that dissimilar from the activities that banks already do. Their investments are pretty much a big mutual fund.

In my judgment, those are all very closely related activities to what banks are already doing and are appropriate to do.

Some of the other activities I see as more experimental in nature. Before we do them on a national level, I like the idea of using the States as laboratories to do some experimenting within the constraints of those States to see how they work. As I said earlier, to try them on for size. If they seem to work well on a State basis, we might consider a regional and national agenda; but in the short run to keep the activities rather constrained geographically and in size and scope.

Senator BOND. Mr. LaWare, would you allow all types of securities underwriting, including corporate equities, in the holding company?

Mr. LAWARE. The concept I think is that broad. I think that the banking industry is far less interested in corporate equity underwriting than they are in corporate debt. After all, we are dealing with corporate debt evaluations in our basic lending activities and that's natural. I think underwriting of equities is a very different animal and, speaking not now for any association or group of banks but for my own company, that would have far less interest to us than the underwriting of debt.

Senator BOND. We have heard examples and horror stories before this committee of specific instances in which a bank with a bad portfolio put that together, securitized it, and marketed it to its customers. And there's a suggestion that the ability to underwrite either debts or equities might allow banks to get out from under questionable loans by selling them off as securities.

What is the solution to that?

Mr. LAWARE. I think one of the underlying thrusts of rationalization for the Glass-Steagall Act initially was the belief that some of the problems of 1929 and 1930 were a derivative of just that kind of activity and indeed there were several instances of that kind of activity. But that was pre-SEC.

Today, the securities industry is very well regulated by the Securities and Exchange Commission and the existence of that regulation under the financial services holding company offers adequate protection against the abuse of securitizing poor assets. We are securitizing assets now all the time, but we find that the only ones we can market are the best ones that we have—our consumer loans, our mortgage loans, the very best that we have.

The whole industry is becoming securitized, if you will, and I think the recognition of that through a vehicle like this is a logical next step.

Senator BOND. For a final question, Mr. LaWare, what consequences do you see if we in Congress are unable to get our act together and do anything further about the whole question of structure and regulation of the financial services industry? What's going to happen? Is it going to be that much worse than what we're likely to do? What are the dangers?

Mr. LAWARE. I think it's a question of competitiveness. I think the competitive position of banks will further deteriorate and it's not just a domestic problem. It's an international problem. I saw a story the other day that the top ten banks in the world no longer include an American bank. Even Citibank at \$200 billion is not in that game.

And that is not because we aren't aggressive and it's not a result of poor economic conditions here or anything like that. It's the result of the fact that the spectrum of things we can do is simply not as broad as that of our competitors, and it's particularly true in the area of securities. The rest of the world has deregulated and broken down the barrier between banking and the securities industry. It's happening in Canada right now. And yet we can't do that.

If we want to take one of our customers directly to the securities market, we have to do it through London or Toronto or some foreign location, and that's exporting a very fundamental financial activity out of this country.

Senator BOND. Congressman, do you have any comments on that?

Representative CARPER. I have no comments on that in particular, sir.

I do have one other comment that I'd like to make if I could. I don't know if this is an appropriate time.

Just before he left, Senator Proxmire raised the question of discretion for the Board of Governors of the Federal Reserve in terms of approving or disapproving the activities of certain subsidiaries of bank holding companies.

The last section of my bill, section 7, actually does spell out a number of areas which can provide a basis for disapproval. They are very similar to those that I enumerated earlier for the Comptroller of the Currency. For example, in situations to prevent undue concentration of resources; a second criteria would be in cases where the Board of Governors simply felt that an institution

didn't have the managerial or financial resources. Those kinds of grounds for disapproval are included and I just wanted to set the record straight.

Senator BOND. Thank you very much, gentlemen. Any further comments either of you wish to offer?

Representative CARPER. I just want to say, as a Member of the House of Representatives and a Member of the Banking Committee, I have been anxious for us not to let the world pass us by. I want us to be out there making policy and not seeing that policy set by the regulators and by the courts. I am earnest in my own desire to make sure that by March 1, 1988 we have taken the steps to set that policy and I commend you and your colleagues here on this committee for taking the initiative and I just want to assure you that there are those of us on the other side of the Capitol who will be pushing very hard and hopefully pulling very hard in the same direction. Thank you.

Senator BOND. I share your enthusiasm and hope, although I would not be willing to wager the ranch, so to speak, on it.

Mr. LAWARE. Senator, I just wanted to say how much I appreciate the opportunity to be here today and to pledge to you that the banking industry is ready to help in the process of sorting all of this out and I hope you will give us an opportunity to work with you.

Senator BOND. Gentlemen, we thank you very much.

There being no further business, we will adjourn the hearing.

[Whereupon, at 11 a.m., the hearing was adjourned.]

[Additional material supplied for the record follows:]

Submitted by Senator Proxmire

QUESTIONS FOR THE RECORD
Financial Restructuring Hearing
August 5, 1987

Mr. LaWare:

(1) You note on page 4 of your testimony that your plan for a Financial Services Holding Company could create added risks for the insured institution and you believe a new Section 23(B) would need to be added to the Bank Holding Company Act. On June 18 Gerald Corrigan agreed that Section 23 of the Bank Holding Company Act would need to be strengthened if banking and other financial services were mixed. He also said, however, that any such consolidated firm "should be subject to at least a degree of consolidated supervisory oversight by the central bank." Do you agree with Mr. Corrigan on the latter point? Please explain your answer.

1. I agree that a degree of consolidated supervisory oversight will be necessary if the Financial Services Holding Company concept is implemented. In particular, such supervision would be necessary to ensure compliance by financial service holding companies with the restrictions on permissible nonbanking activities and adherence to the requirements of Sections 23A and 23B of the Federal Reserve Act and the anti-tie in provisions of the Bank Holding Company Act. However, the Financial Service Holding Company proposal is not intended to impose an additional layer of regulation on financial services companies. As described by the Task Group on Regulation of Financial Services, (Task Group) chaired by Vice President Bush,

Regulation tends to spread in unproductive directions as regulators seek to control isolated occurrences with rules of generalized applicability. While legitimate problems may require a regulatory response, regulations impose unnecessary cost where they apply more broadly than necessary ***** 1

I cannot stress too strongly that, under the financial services holding company proposal, the banking component of the company will continue to be supervised and regulated by the appropriate federal banking agency. With respect to nonbanking subsidiaries, the FSHC proposal is committed to the recommendation of the Task Group that regulation by function should be implemented where practicable so that comparable activities of different types of financial [services companies] are regulated equivalently.² The financial services holding company, inasmuch as it would engage in no other activities except to manage, control and provide services to its subsidiary companies, would not, in my opinion require additional broad-based regulation or supervision.

To the extent that general supervisory oversight of financial services holding companies was considered necessary, that objective could be accomplished by

¹ Blueprint for Reform: The Report of the Task Group on Regulation of Financial Services. September 24, 1984, Reprinted in Federal Banking Law Reports, Number 1050, Commerce Clearing House, November 16, 1984, 37

² Id. at 39

designating an existing agency or establishing a new agency to coordinate the efforts of the functional regulators to ensure that national policy objectives were considered in the course of regulating the discrete components of the financial services holding companies. I would envision that this agency would have access to reports from the regulatory agencies and would function as a somewhat enhanced Federal Financial Institutions Examination Council, with the specific purpose to foster and encourage cooperation and coordination among the various state and federal regulators of financial service companies.

(2) Repeal of Glass-Steagall: Your proposal would repeal the Glass-Steagall prohibitions separating commercial banking from investment banking. Among other things, this would allow a banking organization to engage in underwriting equity securities and long-term corporate securities through separate affiliates. I am sure our friends in the investment banking community will argue that these affiliations could bring on abuses similar to those that occurred in the 1920's that led Congress to pass the Glass-Steagall Act. What is your response to these arguments?

2. The "abuses" in the securities markets in the 1920's such as inadequate disclosure of information to investors and stock price manipulation were not confined to the investment banking activities of commercial banks, but were common to all participants in the securities market. These abuses have been adequately addressed by other legislation such as the Securities Act of 1933 and the Securities Exchange Act of 1934, and the existence of numerous self regulatory organizations. Our proposal for the Financial

Services Holding Company structure emphasizes functional regulation thereby putting investment banking activities of commercial banking under direct supervision of the Securities and Exchange Commission.

Any potential abuses that existed in the 1920's that were peculiar to commercial banks (and/or their affiliates) such as disposition of bad loans to the public, were more effectively dealt with by other provisions of the Banking Act of 1933 and the addition of Section 23A to the Federal Reserve Act which limits transactions between member banks and their affiliates.

While the Glass Steagall Act was one of many pieces of legislation addressing the structural defects of the banking system at that point in history, it did not accomplish its goal of strengthening the banking system - other pieces of legislation were more crucial and remedial. The creation of the Federal Deposit Insurance Corporation was the single most important contribution to the creation of public confidence in the stability of the banking system. In fact, separating commercial banking and investment banking has become detrimental to the strength of our banking system through the evolution of time and changing credit markets. The Glass Steagall Act prevents United States based financial institutions from competing effectively in the current global economy.

(3) Transfer of Activities: Your proposal would allow a financial services holding company to own companies engaged in any activity permitted a bank holding company. This would seem to make it possible for a bank holding company to transfer all of its nonbanking activities from the bank holding company to the parent financial services holding company. The effect of this transfer would be to remove the ability of the Federal Reserve to examine the books of the companies now under the bank holding company. Is this result intentional, and if so, what is its justification?

3. Transfer of Activities It is true that, upon formation of a financial services holding company, those nonbanking activities currently conducted through a bank holding company might be transferred from the bank holding company into separate subsidiaries of the financial services holding company. It is not the intention of the financial services holding company proposal to remove any companies from appropriate regulation. I believe, however, that examination of all of the subsidiaries of a bank holding company simply because they are subsidiaries of bank holding companies does not advance any articulated public policy. Where there are public policy justifications for government regulation of a particular activity, such as securities or insurance activities, these regulations are already in place. Furthermore, under section 23A and the new section 23B of the Federal Reserve Act transactions between federally insured banks and their nonbanking affiliates are severely restricted. These currently existing provisions of law are adequate to address any concerns that a holding company or its nonbanking affiliates might endanger the solvency of the banking component of the financial services holding company.

Thus, under the FSHC proposal, to the extent that the activities of the transferred companies are currently subject to state or federal regulation under the functional regulation approach, those companies would continue to be regulated. Those activities that are not currently subject to regulation would no longer be subject to examination by the Federal Reserve System.

(4) Management of Risk: One of the central issues involved in holding company regulation is whether the bank subsidiary can be insulated from the possible failure of any of its affiliates. One view is that as long as the affiliate is legally separated from the bank and separately capitalized, its failure should not put the bank in jeopardy. However, in the real world, the public tends to look on the entire corporate organization as a single entity. As Walter Wriston observed, "if your name is on the door you can't allow an affiliate to fail."

If this is true, then your proposal would substantially raise the risk to the bank and ultimately the FDIC and the Federal Reserve without any effective means for the regulatory authorities to contain that risk. How do you respond to these potential dangers?

4. Management of Risk I believe that an effective firewall can be constructed between banking and nonbanking affiliates of a financial services holding company. Currently, section 23A of the Federal Reserve Act imposes severe limitations on the ability of a federally insured banking affiliate to come to the financial rescue of an affiliated nonbanking company. The recently enacted section 23B of the Federal Reserve Act

has added new safeguards to prevent a banking affiliate from providing funds to bail out a failing nonbanking affiliate.

The financial services holding company, on the other hand, by virtue of being able to diversify into financial activities other than strictly banking, could be in a strengthened position to provide additional financial support to its subsidiaries, including its banking subsidiaries, by virtue of the financial services holding company's ability to access the capital markets.

(5) FED Examinations: Your legislative proposal does not seem to allow the Federal Reserve to conduct periodic examinations of the parent financial services holding company or its subsidiaries. The FED would have to rely on reports from the company that it was in compliance with the activity restrictions. If the Federal Reserve does not have independent examination authority, how can it be sure that the activity limitations are really being complied with?

5. Examinations It is true that the proposal does not include examination of financial services holding companies or their subsidiaries by the Federal Reserve Board. I believe however, that the voluntary reporting structure contemplated by the proposal would provide accurate and complete information to the Federal Reserve System concerning the activities of the financial services holding companies.

First of all, the reports are required to be under oath, while an oath does not guarantee accurate and complete

reporting, the requirement is something that I and all the members of my organization take seriously. Furthermore, the proposal contains severe penalties for financial services holding companies that have failed to comply with the activities restrictions. In my view, it would not be worth the risk for a financial services holding company to violate the activities restrictions and be faced with the possibility of a cease and desist order, civil money penalties or divestiture as well as the publicity attendant upon the imposition of such penalties.

Finally, even if the FSHC chose to take the risk of engaging in an impermissible activity and did not report the activity to the Federal Reserve, it is likely, indeed probable, that the violation would be reported by a competitor, either a competitor financial services holding company or a competitor in the impermissible nonbanking activity.

Under these circumstances, and giving particular consideration to the competitive nature of the financial services industry, I do not believe that the proposed system would result in wholesale violations or that any particular violation would remain unreported and unpunished for any period of time.

(6) The diagram of your proposed financial services holding company located at the end of your written statement appears quite impressive. Of course this is on paper. Tell me, is there any legal precedent or current law that would protect the financial services holding company from having to meet the claims of creditors due to the failure of a subsidiary

of the holding company? What will stop a holding company from "propping up" a sick real estate subsidiary, or securities affiliate with bank funds that are insured by the Federal government?

6. Each corporate entity within the financial services holding company is to be viewed separately for purposes of determining the legal rights of creditors. This is basic hornbook law and has been a fundamental part of American jurisprudence for many decades. Absent a written guaranty of the indebtedness from a parent company or from an affiliate, it is almost impossible for a creditor of a particular subsidiary to assert a claim against an affiliated corporation and thereby pierce the corporate veil. There are additional safeguards built into the federal banking laws which would prevent the use of deposits in a federally insured bank to bail out a sister corporation experiencing financial difficulty. This legal protective framework is in place at the present time and it has worked well. The legal prohibitions against improper use of bank assets cannot prevent all abuses. However, the record shows that those individuals who do violate the federal banking laws relating to misuse of funds are punished swiftly and with tough prison sentences and fines.

I note, however, there is nothing in the proposal that would stop, and I believe that there is nothing that should stop the financial services holding company from coming to the aid of its subsidiary bank through funds generated from sources separate from the banking affiliate. As you are

aware, the Federal Reserve Board has recently issued a policy statement that reiterates the Board's position that bank holding companies shall serve as sources of financial and managerial strength to their subsidiary banks. Under this policy, the bank holding company must stand ready to provide capital funds to a subsidiary bank during periods of financial stress. The existence of a diversified financial services holding company enhances the possibility that the holding company will be in a position to make funds available to the bank in times of stress.

(7) I'm quite concerned that the financial services holding company structure that you advocate will further concentrate economic power within a relatively few financial service firms. Won't the creation of these huge new "mega-firms" allow them to exert their economic power to eradicate the tens of thousands of mom and pop type community financial service organizations that made our nation strong? Does our nation really need these new "mega-firms" to effectively deliver financial service products to consumers?

7. The Financial Services Holding Company that we advocate reflects the view that commercial firms such as General Motors or Ford should not be affiliated with a bank holding company. We believe that if such affiliations were permitted, they could lead to an undesirable concentration of economic resources.

With regard to companies "financial in nature," each industry -- banking, securities, insurance and real estate -- has different levels of concentration and different yardsticks by which concentration is measured. It is not

all clear that, taken either separately or together, concentration in these industries should be considered a problem. In banking, for example, the industry is noteworthy for its lack of concentration. Moreover, there has never been agreement among academicians about what should constitute a true measure of concentration in banking. Should it relate to deposit-taking or to the granting of commercial or consumer credit? If deposits are considered as the criterion, should foreign deposits be aggregated with domestic deposits, and should the deposits in thrift institutions and such near-deposits as money market funds be included? Citicorp for example as the nation's largest bank holding company, has less than two percent (2%) of the domestic deposits of all U.S. banks; if deposits of thrift institutions are included, this number drops to about 1.35%. There is no evidence that the growth of bank holding companies has led to adverse concentration in the national banking market. It is relevant to note that the number of commercial banks, 14,200, is the same as it was ten years ago. Even with the spate of mergers that have occurred, many new banks have been formed as well. Concurrently, foreign banks not subject to many of the restrictions placed on American banks continue to garner a growing share of U.S. banking assets. Using yardsticks applicable to their industry, the securities and insurance businesses turn out to be more concentrated than the banking industry. For example, the ten largest life insurance companies have 43 percent of the industry's

assets. Nevertheless, with thousands of firms in the life insurance industry, and with relatively easy entry, the life insurance industry need not be considered overly concentrated. With regard to the securities industry, various criteria may be used, and some show significant concentration. For example, the New York Times reported that the top ten corporate underwriters accounted for 91 percent of all volume of new corporate issues in 1985; by a different measure, the Securities Industry Association reported that in 1984 the top ten firm's total underwriting revenues came to 48 percent of the total for the industry.

By eliminating artificial barriers to entry of bank holding companies into other financial services activities, and allowing for reciprocity, the Financial Services Holding Company can promote increased competition, which should be the guiding principle for antitrust policy in any industry. And because commercial and manufacturing firms would not be allowed to establish FSHC's, there is no possibility that corporate combinations along the lines of Japanese or German models could emerge.

(8) Large Mergers: Your proposal would open up the way for merging large banks with large securities firms or large insurance companies. For example, Citicorp, Aetna and Merrill Lynch could all join together under the roof of a financial services holding company. Whoever manages that holding company would have enormous economic and financial power.

Are you concerned about the concentration of economic and financial power that might result from your proposal, and if so, are there any safeguards that you could suggest to prevent undue concentration?

8. Large Mergers This proposal is not intended to undercut the antitrust scrutiny which would be present for mergers among the larger firms in various sectors of the financial services industry and, in our view under current law, such mergers are unlikely to occur. There are antitrust laws in existence now that have been applied to mergers among large firms, including mergers among large financial firms, and we would expect that the safeguards provided by these laws would prevent and guard against any undue concentration of financial and economic power.

The key question is whether the proposed combination is procompetitive and hence should benefit the consumer.

Currently, securities and insurance firms can combine among themselves in any way they choose. Unlike bank holding companies, there are no business line restrictions.

Antitrust laws have been applied to them and there has been no undue concentration of resources, and no bad effects.

We believe that the addition of banking into this field will not alter the effectiveness of the present system.

Essentially, our proposal would allow bank holding companies to play under the same rules that are currently in force.